NEC CORPORATION

Annual Report 1998

Global Competence

Global Competence

Global Competence

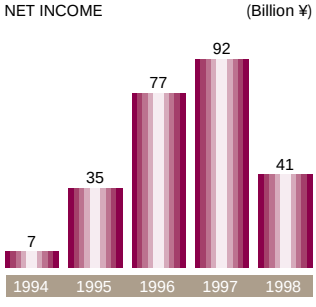
Global

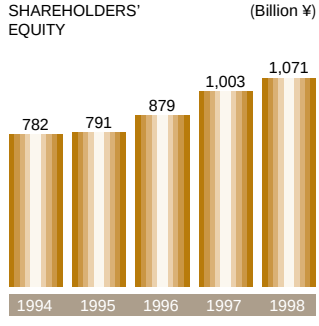
Financial Highlights

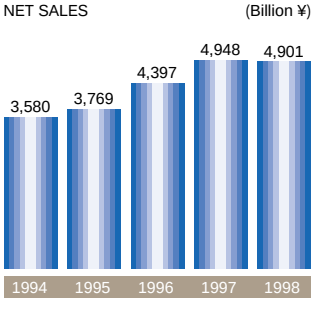
NEC CORPORATION AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 1996, 1997 and 1998

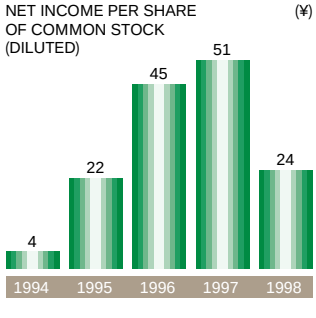
	In millions of yen			In thousands of U.S. dollars	Percent change
	1996	1997	**1998**	**1998**	1998/1997
Net sales	¥4,397,192	¥4,948,437	**¥4,901,122**	**$36,850,541**	–1%
Information/communications systems operations	3,169,874	3,765,074	**3,694,488**	**27,778,105**	–2
Communications systems and equipment	1,227,016	1,686,594	**1,717,259**	**12,911,722**	2
Computers and industrial electronic systems	1,942,858	2,078,480	**1,977,229**	**14,866,383**	–5
Electron devices operations	1,032,983	963,176	**988,784**	**7,434,466**	3
Others	194,335	220,187	**217,850**	**1,637,970**	–1
Income before income taxes	151,318	121,222	**90,993**	**684,158**	–25
Income taxes	76,376	24,900	**48,033**	**361,150**	93
Net income	77,166	91,581	**41,302**	**310,541**	–55
Per share of common stock (in yen and U.S. dollars):					
Net income					
Basic	49.98	59.05	**25.94**	**0.195**	–56
Diluted	45.14	51.38	**24.05**	**0.181**	–53
Cash dividends	11.00	11.00	**11.00**	**0.083**	0
Per American Depositary Share, each representing 5 shares of common stock (in yen and U.S. dollars):					
Net income					
Basic	250	295	**130**	**0.98**	–56
Diluted	226	257	**120**	**0.90**	–53
Cash dividends	55	55	**55**	**0.41**	0
Total assets	4,683,120	4,799,165	**4,973,836**	**37,397,263**	4
Shareholders' equity	878,852	1,003,371	**1,070,757**	**8,050,805**	7
Capital expenditures	401,999	405,772	**385,346**	**2,897,338**	–5
R&D expenses	298,713	348,537	**381,239**	**2,866,459**	9
Employees	152,719	151,966	**152,450**		0

Note: U.S. dollar amounts are translated from yen, for convenience only, at the rate of ¥133=U.S.$1.









An Interview with the Management

Hisashi Kaneko, President　　*Tadahiro Sekimoto, Chairman of the Board*

Q Please give an overview of NEC's business environment in fiscal 1998, ended March 31, 1998.

A The Japanese economy remained stagnant in fiscal 1998, primarily due to suppressed consumer spending and ongoing concerns about the stability of Japan's financial system. Overseas, the U.S. economy continued to expand and European economies showed mild recoveries. Meanwhile, the currency crisis affecting Asia caused a slowdown in economic growth in that region.

>> In the electronics industry in Japan, the end of an investment cycle in mobile communications infrastructure, sluggish demand for personal computers (PCs) and consumer electronics products, and price erosion in memories have depressed the market. Overseas, markets remained brisk as investment in information and communications systems spurred by ongoing developments in digital and networking technologies compensated for the dampening effects of falling memory prices and the currency crisis in Asia.

Q What were NEC's performance results under such conditions?

A In fiscal 1998, consolidated net sales slipped 1 percent from the previous fiscal year, to ¥4,901.1 billion ($36,851 million). Sales of communications equipment increased due to favorable communications infrastructure business in overseas markets, which offset the negative impact from the completion of an investment cycle in mobile communications infrastructure in Japan. Computer sales decreased, primarily owing to the weak PC market in Japan. Electron devices recorded higher sales, supported by strong demand for microcomputers and other system LSIs (large-scale integrated circuits), despite the adverse effects of falling memory prices.

>> The ratio of overseas sales to net sales increased to 24 percent, from 22 percent in the previous year. This rise was attributable to strong sales of communications equipment and semiconductors.

>> Net income fell 55 percent, to ¥41.3 billion ($311 million), due primarily to a drop in memory prices and lower corporate tax benefits compared to the unusual case of the previous fiscal year. Cash dividends per share of common stock were ¥11.00 ($0.083), including an interim dividend of ¥5.50 ($0.041) per share paid in December 1997.

Q What were the effects of the currency crisis in Southeast Asia on overseas business and how is NEC responding?

A NEC has a long and proud history in Southeast Asia. As part of its strategy for globalization, NEC has established manufacturing and marketing affiliates mainly for the communications systems and semiconductors businesses. The recent sharp drop in the exchange rate values of Southeast Asian currencies has resulted in currency valuation losses for those overseas affiliates burdened with foreign debt. Fortunately, these negative factors have had a limited effect on NEC's consolidated earnings. On the positive side, the crisis has boosted the cost-competitiveness of local manufacturing affiliates, who have a large proportion of exports to countries outside Asia.

>> Although the recovery of Southeast Asian economies may take some time, from a medium-to-long-term perspective, the prospects for further growth in Asian markets remain strong, especially in the area of communications infrastructure. NEC is committed to developing its business while keeping a close eye on trends in individual economies and exchange rates as well as constantly balancing the costs and benefits of maintaining or expanding manufacturing facilities in the region.

Q What are NEC's global competencies?

A With the advent of the "borderless" society brought on by economic globalization and advances in information technology, strengthening global competencies has never been more important.

>> NEC's core global competence—and the area on which it places the highest priority—is technology. To sharpen NEC's competitive edge, in addition to boosting market-focused R&D activities, it is imperative to apply innovative technologies to bring new products to the market ahead of the competition.

>> Moreover, NEC is working to enhance what it calls "total management skill" to turn promising technologies into viable businesses. For example, NEC is building on innovative manufacturing techniques, such as lean production and concurrent engineering. NEC is continuously seeking innovations in business processes across the entire spectrum of its operations, including sales, procurement, human resources, and finance, to bring a new level of competence to NEC.

Q What are some of the specific products and technologies where NEC has global competencies?

A NEC provides a wide range of globally competitive products that will be the foundation for ensuring its continued profitability. In communications equipment, NEC is promoting NEAX61Σ digital switching systems, fiber-optic transmission systems (FOTS's), and a wideband code division multiple access (W-CDMA) system, which is expected to be the global standard for next-generation mobile communications systems.

>> In the computer business, NEC's Express5800 series of PC servers, which offers among the world's highest performance while complying with global technology standards, has the number one market share in Japan and a growing market overseas. In a particularly significant development in its PC business, NEC introduced the PC98-NX series, which conforms to new global standards for next-generation PCs.

>> In electron devices, NEC is expanding its SOC (system on a chip) business by leveraging its comprehensive technological strengths in semiconductor development. NEC is also developing highly competitive color plasma display panels (PDPs), which are expected to enjoy strong demand in the multimedia age.

Q What are NEC's strategies for promoting alliances with other companies to develop global businesses?

A While technologies developed in-house are the backbone of our technological competencies, alliances are necessary to supplement our technologies and product lineup as well as to reduce the burden of R&D costs in a broad range of operations. Such tie-ups with other companies to augment expertise and accelerate the process of bringing new products to the market are a crucial part of today's business.

>> NEC has established a joint venture company in the United Kingdom to develop radio technologies for next-generation mobile communications systems. NEC is also working to strengthen its global PC business through its affiliate Packard Bell NEC, Inc. In addition, NEC has signed agreements with Microsoft Corporation to develop next-generation PC servers and with Hewlett-Packard Company for the development and sale of large-scale UNIX servers. Other major NEC alliances include agreements with MIPS Technologies, Inc., to develop reduced instruction set computer (RISC) microprocessors and with Lucent Technologies Inc. for the development of next-generation complementary metal oxide semiconductor (CMOS) processors.

Q As a global enterprise, what steps is NEC taking to protect the environment?

A NEC looks at environmental issues from a global viewpoint and places top priority on growth in harmony with nature. In Europe, where environmental awareness is particularly high, NEC established the European Environmental Center, in Germany, for the purpose of collecting information on environmental activities. In addition, 48 NEC facilities, including R&D, design, and manufacturing facilities, have received ISO14001 certification, awarded by the International Organization for Standardization upon meeting requirements related to environmental management systems. NEC will continue to develop and enhance its environmental technologies at every stage and across every area of business, including development, production, sales, distribution, and disposal.

Q What is the outlook for the electronics industry for fiscal 1999, ending March 31, 1999?

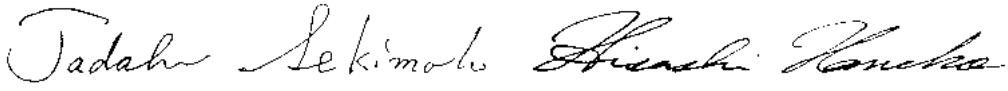
A In Japan, the economy is forecast to remain weak, with the government's economic stimulus package beginning to take effect in the second half of fiscal 1999. The world economy should continue to grow, especially in the United States and Europe, while Asian economies will again experience slower growth.

>> Against this backdrop, overseas markets for electronics products should remain firm with continued investments in information and communications systems. In the domestic electronics industry, NEC forecasts a gradual recovery in the second half of fiscal 1999 due to increased demand for PCs following the introduction of Windows® 98—a new operating system for PCs—and the spreading use of mobile computing, a recovery in corporate investment in information infrastructures, and gradual improvements in the balance of supply and demand for memories.

>> Amid this business environment, NEC will continue to improve its earnings structure by lowering costs, further controlling overhead expenses, and keeping a sharp eye on market demand in production control. NEC will strengthen its overseas business in communications systems and equipment, expand its systems integration business, and further expand its system LSI business.

>> As always, NEC remains committed to benefiting its shareholders, customers, and employees and will continue to help advance societies worldwide through its C&C technologies.

June 26, 1998



Tadahiro Sekimoto
Chairman of the Board

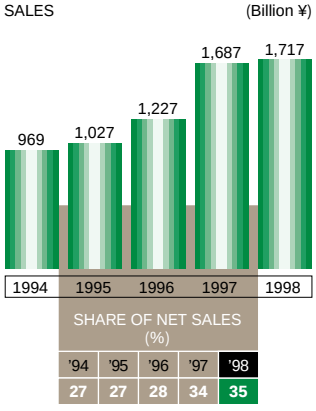
Hisashi Kaneko
President

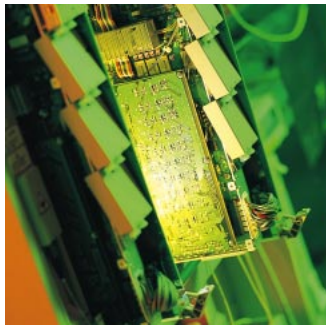
Fiscal 1998

INFORMATION/COMMUNICATIONS SYSTEMS OPERATIONS

Communications Systems and Equipment

Sales of communications systems and equipment increased 2 percent, to ¥1,717.3 billion ($12,912 million). While sales of mobile communications systems were weak in Japan, growth in NEC's domestic cellular handset sales was encouraging. Overseas sales were favorable, particularly of switching systems.

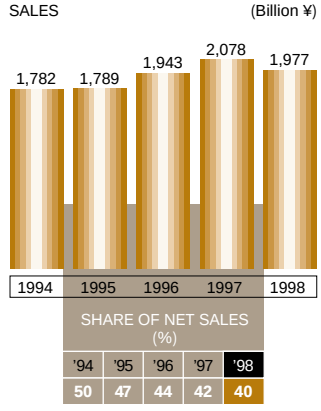




■ Digital central office switching systems ■ Mobile communications systems ■ Digital PBXs ■ Packet switching systems ■ Network management systems ■ Intelligent network systems ■ Fiber-optic transmission systems ■ Fiber-optic submarine cable systems ■ CATV systems ■ Teleconferencing systems ■ Routers ■ Hubs ■ Data modems ■ Microwave communications systems ■ Satellite communications systems (satellite-mounted and ground support communications equipment) ■ Television and radio broadcast equipment ■ Video and studio equipment ■ Aircraft and space electronic equipment ■ Satellites ■ Rocket guidance and control equipment ■ Radio navigation and radar equipment ■ Defense electronic systems ■ Cellular phones ■ PHS terminals ■ Pagers ■ Facsimile equipment ■ Key telephone systems ■ ISDN terminals ■ Installation and maintenance of communications systems

Computers and Industrial Electronic Systems

Sales of computers and industrial electronic systems were down 5 percent, to ¥1,977.2 billion ($14,866 million). Although both the software and systems integration business and the server business enjoyed strong growth, PC sales fell sharply due to a stagnant domestic market.

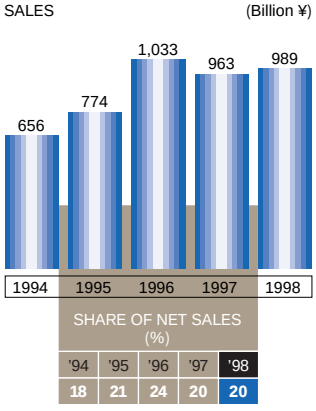


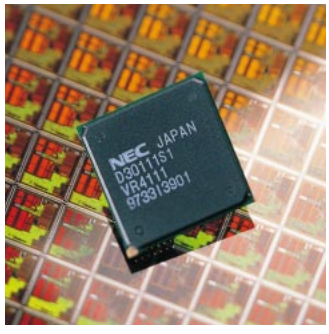
■ PCs ■ Mainframe computers ■ Servers ■ Workstations ■ Supercomputers ■ Terminal equipment ■ Word processors ■ Monitors ■ Printers ■ CD-ROM drives ■ Hard disk drives ■ Optical disk players ■ CAD/CAM and CAE systems ■ Automated fingerprint identification systems ■ Medical electronic equipment ■ Telemetry and remote control systems ■ Postal automation systems ■ Communications network control systems ■ Building automation systems ■ Educational electronic equipment ■ Computerized numerical control equipment ■ YAG laser equipment ■ Underwater ultrasonic application equipment ■ Semiconductor manufacturing equipment and vacuum equipment ■ Measuring and testing systems ■ Car electronic products ■ Software products ■ Systems integration services ■ Maintenance of computers and related equipment ■ VAN information services ■ Internet services

at a Glance

ELECTRON DEVICES OPERATIONS

Sales of electron devices were ¥988.8 billion ($7,434 million), up 3 percent. The increasing digitization of electronic equipment supported higher sales of microcomputers and other system LSIs. Despite growing demand for dynamic random access memories (DRAMs), a deterioration in prices caused memory sales to decline. Sales of color liquid crystal displays (LCDs), primarily for use in PC monitors, rose.



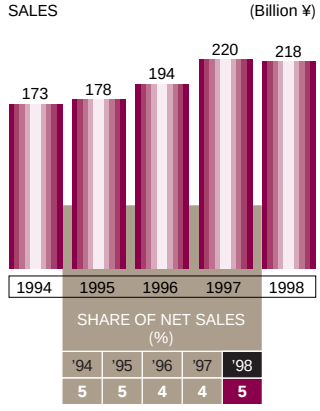


■ Memories ■ Microcomputers ■ Gate arrays ■ Cell-based ICs ■ Linear ICs ■ Charge-coupled devices ■ Transistors ■ Gallium arsenide transistors and ICs ■ Diodes ■ Optical semiconductor devices ■ Hybrid ICs ■ TFT color LCDs ■ Color display tubes ■ Electroluminescent lights ■ Capacitors ■ Printed wiring boards ■ Relays ■ Hermetic seals ■ Electron tubes ■ Gas lasers ■ Electrical connectors ■ Color plasma display panels

OTHERS

Sales of others decreased 1 percent, to ¥217.9 billion ($1,638 million).

NEC has ceased the production of conventional TVs and repositioned its TV business, focusing on high-value-added TVs with its digital technologies. The first product that has emerged from this new approach is InterRakuTV, a high-resolution, wide-screen TV with a built-in hard disk drive, which makes Internet browsing and sending e-mail as easy as watching TV.



In the area of projectors, NEC launched the XL-3500, a high-resolution digital light processing projector that boasts a brightness of 3,500 ANSI lumens and high picture quality, making it ideal for use in large meeting halls.

Color PDPs represent a core technology for NEC's multimedia business. In October 1997, NEC announced the world's first 50-inch plasma TV with a wide aspect ratio, utilizing its newly developed color PDP with exceptional picture quality. In addition, NEC introduced a 42-inch plasma TV in Japan and a 42-inch PDP monitor internationally, each of which is 10mm thinner than previous models, and at 89mm, is the world's thinnest in its class. NEC remains dedicated to developing new products for the multimedia age.

The 50-inch high-definition plasma TV

■ Color TVs (HDTVs, Internet TVs, Plasma TVs) ■ Video projectors ■ DBS receivers ■ VCRs ■ Video game units ■ Home appliances ■ Lighting products ■ Cleaners

Q Demand for communications systems is expected to continue to expand. What is NEC doing in the area of next-generation communications systems?

A First NEC is working with NTT DoCoMo (NTT Mobile Communications Network, Inc.) on a W-CDMA system, the standard for the third-generation mobile communications system in Japan and Europe, which is poised to become the global standard, under the name of IMT-2000. With its technological capabilities in this area, NEC will capitalize on opportunities in such regions as Europe and Asia, including Japan.

>> Anticipating the global trend toward digital broadcasting, NEC has delivered commercial digital terrestrial broadcast equipment to the United Kingdom and intends to leverage its large share in the world market for broadcast equipment to further boost its business. In addition, NEC has an exemplary track record in carrier networks with transmission equipment using wavelength division multiplexing (WDM) technology and asynchronous transfer mode (ATM) switching systems, which are indispensable for the high-speed processing of multimedia information. With such advanced products and technologies, NEC can offer complete network solutions to customers worldwide.

In fiscal 1998, sales of communications systems and equipment increased a slight 2 percent over the previous period, to ¥1,717.3 billion ($12,912 million), and accounted for 35 percent of net sales. Although sales of cellular phones were buoyant, domestic sales fell overall due to a leveling off of infrastructure investment by cellular operators. Strong overseas sales were largely attributed to growth in sales of switching systems.

>> Sales of **switching systems** rose, chiefly due to an increase in shipments to Latin America, Russia, and other overseas markets, which compensated for a decline in domestic sales. NEC's ATM switching system—selected as the core switching system for the next-generation network at Sprint Corporation, of the United States, one of the world's largest telecommunications providers—started operation. This event will serve as a springboard for future gains in the U.S. market.

>> Sales of **mobile communications systems** fell sharply during the term. Although the number of new subscribers to cellular phone services in Japan continues to rise, NTT DoCoMo and the new common carriers (NCCs) completed a phase of investment in extra capacity, causing a decline in sales.

>> **Transmission systems** sales were level with the previous period. Domestic sales fell, owing to the completion of a round of investment in integrated services digital network (ISDN) related systems to combat burgeoning Internet congestion. Overseas sales of synchronous digital hierarchy (SDH) systems rose, reflecting increasing Internet traffic, and sales of access systems in Russia and Asian countries outside Japan were robust.

>> Sales of **radio systems**, including microwave communications systems, broadcast equipment, and satellite communications systems, were even with those of the previous term. Delivery of a satellite communications system to ICO Global Communications Holdings B.V. boosted overseas sales.

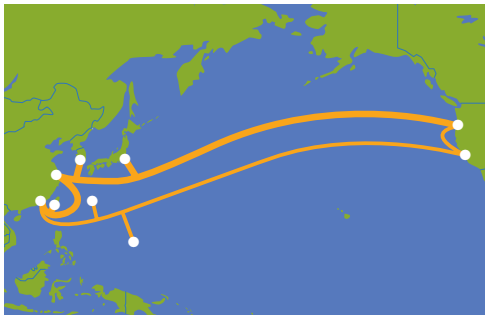
>> NEC registered sales gains in **mobile communications handsets and other equipment**, which include cellular phones, facsimile equipment, and pagers. The Digital mova N203 Hyper, which at 92 grams was the world's lightest cellular phone at the time of its launch, boosted NEC's market share.

Highlights of the Year

- ☐ Digital mova N203 Hyper, a cellular phone, sold well in Japan
- ☐ ATM switching systems, delivered to Sprint Corporation, starts operation
- ☐ The world's first commercial digital terrestrial broadcast equipment delivered to the United Kingdom
- ■ Orders for SDH systems received from China
- ■ High-capacity D-WDM system developed
- ■ Order awarded for submarine cable project linking the United States and China
- ■ New wireless terminal adaptor announced

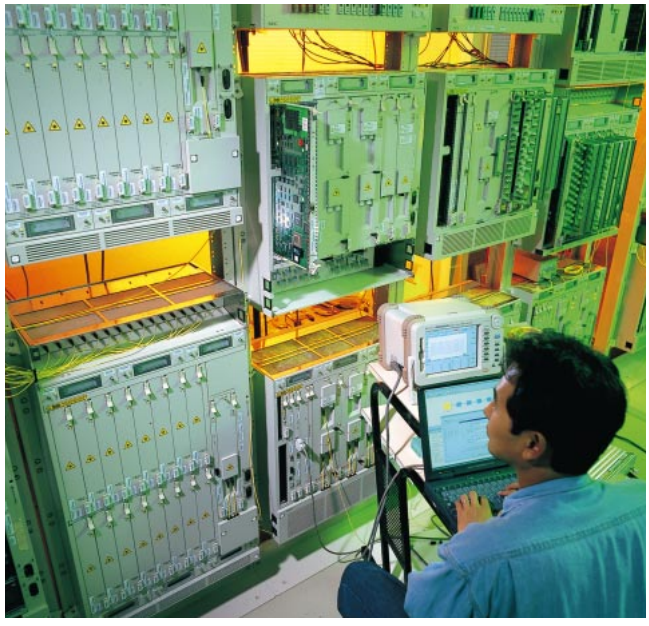
NEC Awarded Submarine Cable Project Linking the United States and China

Some 50 companies, including Nippon Telegraph and Telephone Corporation (NTT), Kokusai Denshin Denwa Co., Ltd. (KDD), both of Japan, China Telecom, and AT&T Corp., of the United States, are cooperating on a submarine cable project in response to increasing communication traffic in the Asian-Pacific region. WDM technology will be used in a 30,000-kilometer loop linking China, the United States, Japan, Korea, and Taiwan to create an international communications infrastructure for these countries' multimedia needs in the 21st century. NEC, together with a KDD subsidiary, has received an order to construct 15,000 kilometers of the network.



NEC Develops High-Capacity D-WDM System

WDM allows the simultaneous transmission of multiple optical signals through a single optical fiber, thus economically expanding capacity in optical networks. NEC developed a dense-WDM (D-WDM) system and delivered it to Frontier Communications International, Inc., the sixth largest long-distance telecommunications provider in the United States.



Furthermore, NEC has outpaced its competition with the development of a D-WDM system with optical add/drop capabilities.

AtermIW60 Wireless Terminal Adaptor Released

In December 1997, NEC released AtermIW60, which in addition to conventional terminal adaptor (TA) functions allows users to easily create

wireless digital networks in the home by using personal handyphone system (PHS) handsets. Through integration with ISDN and PHS systems, AtermIW60 enables the easier use of networks in small offices and home offices (SOHOs).

NEC has a leading share of the Japanese TA market, and its superior technologies are winning praise.

NEC Wins Orders for SDH Systems from China

In October 1997, NEC received an order from China to build one of the world's largest SDH microwave trunk networks connecting Beijing to Guangzhou. NEC received another order for SDH FOTS's trunk networks connecting Hohhot to Beihai.

The Chinese government has given priority to communications infrastructure development to support economic expansion. The orders—awarded from among bids by major global competitors—attest to NEC's strong reputation for superior technology and reliability as well as an established history in China.

Q What is NEC doing to develop its computer business in today's increasingly competitive information technology market?

A With a soaring number of users, the Internet has rapidly become commonplace in recent years, focusing attention on new information systems adopting the latest Internet technology. In 1997, NEC introduced a new framework to construct information systems, named the WebComputing Framework, which incorporates Internet technology and distributed object technology. Playing a pivotal role in this framework are our competitive Express5800 series of PC servers and PC98-NX series of PCs. On the software side, NEC is strengthening its product lineup, not only through its own development efforts but also by acquiring cutting-edge information technology through alliances with other companies. NEC's leading-edge systems integration services make full use of these competitive hardware and software products to offer customers optimal solutions. The WebComputing Framework is the key to increasing sales and earnings in NEC's computer business.

In fiscal 1998, sales of computers and industrial electronic systems decreased 5 percent, to ¥1,977.2 billion ($14,866 million), and accounted for 40 percent of net sales. Despite the sluggish domestic economy, corporate investment in information systems was firm, reflecting the increased use of the Internet and local area networks (LANs). For this reason, NEC's sales in software, systems integration, and server businesses expanded, but, due to a slump in the domestic PC market caused by stagnant consumer spending, PC sales fell severely.

>> **Software and systems integration business** grew, thanks to increasing corporate need for information sharing via groupware as well as for data analysis and decision-making support through the utilization of Data Warehouse software.

>> As for **mainframes**, shipments of small-scale models grew on account of the introduction of products with dramatically improved price performance. However, because shipments of medium-sized and large mainframes decreased, overall sales remained at almost the same level as the previous period.

>> Sales of **servers** rose, thanks to the increasing need for open systems and an expansion in the use of PCs in network environments. With a broad product lineup and extensive sales and support channels, market share grew for the Express5800 series, already Japan's best-selling line of PC servers. In fiscal 1998, NEC formed an alliance with Microsoft Corporation in the enterprise server field, including the codevelopment of next-generation high-performance servers for mission-critical operations. Furthermore, NEC's UNIX server, which offers high reliability, enjoyed strong sales.

>> Meanwhile, sales of **PCs** dropped, as domestic sales of consumer desktop PCs were especially poor. In an era of worldwide network connections, the adoption of global standards is imperative to NEC's success. During the term, NEC moved away from a strategy of proprietary PC standards by launching the PC98-NX series, which conforms to new global standards for next-generation PCs. In overseas business developments, Packard Bell NEC, an affiliated company that recorded a loss in 1997 due to intensified competition in the U.S. PC market, has been implementing restructuring measures, including the consolidation of its facilities.

>> NEC manufactures and sells **industrial electronic systems**, including network management systems, postal automation systems, and factory automation systems. Sales of postal automation systems rose substantially, due to the introduction of new sorting machines accompanying the change of Japan's postal codes from five to seven digits.

Highlights of the Year

- ☐ Share expands for market-leading Express5800 series of PC servers
- ☐ Alliance with Microsoft Corporation formed in enterprise server field
- ■ PC98-NX series, conforming to new global standards, launched
- ☐ WebComputing Framework for constructing new information systems announced
- ■ Order received for basic architecture design for ultracomputer
- ■ Multimedia service business established in Australia
- ■ Shipment of postal automation systems to Finland begun

Shipment of Postal Automation Systems to Finland Begun

NEC has begun supplying Finland Post with the latest automated postal processing systems. As well as improving the ability to scan addresses and postal codes, convert this information into barcode form, print the barcode on the item, and sort items in the order of delivery, NEC's new system boasts highly accurate alpha-numeric handwriting recognition technology. Through this technology, NEC aims to increase its global market share in postal automation systems.

Multimedia Service Business Established in Australia

NEC Australia Pty. Ltd. was contracted by the state of Victoria, Australia, to build and administer a system for an electronic public service, called Electronic Service Delivery. To administer this service, NEC Australia established Maxi Multimedia Pty. Ltd., a joint venture with a local software company.

With the Electronic Service Delivery, state residents will be able to enjoy such convenient public services as electronically paying utility bills and applying

for certificates at kiosk terminals placed in public locations or by telephone or Internet-connected PCs in the home and office.

PC98-NX series, Conforming to New Global Standards, Launched

With the development of the multimedia age, demand is growing for new PCs that can readily handle a variety of data, including text and graphics, in network environments.

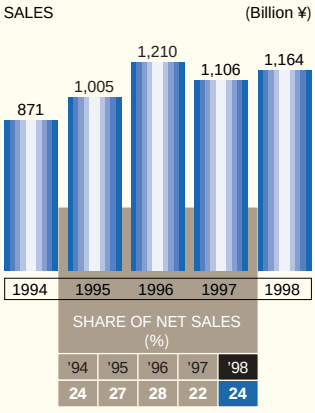
NEC launched the PC98-NX series, which complies with "PC97/PC98 System Design," new global PC standards advocated by Microsoft Corporation and Intel Corporation, both of the United States. This new series boasts superior operability, including fast start-up and simple peripheral connection. It also offers a faster processing capability for large amounts of multimedia data in network environments.

Order Received for Basic Architecture Design for Ultracomputer

As part of its Earth Simulator Project, Japan's Science and Technology Agency is planning for the fiscal 2002 introduction of an "ultracomputer" with approximately 1,000 times the execution speed of the existing supercomputer used in the meteorological and environmental fields. NEC received an order to draw up the basic architecture design for this project.

The Earth Simulator Project will establish a computerized "virtual earth" to study and simulate the process of long-term climatic change. Through participation in this project, NEC hopes to contribute to solving environmental problems.

During fiscal 1998, overseas sales increased 5 percent, to ¥1,164.1 billion ($8,753 million), and accounted for 24 percent of net sales. This rise was attributable primarily to strong sales of communications infrastructure equipment in Asia, Latin America, and Europe as well as of semiconductors in Asia, Europe, and North America.



ASIA AND OCEANIA

The sharp depreciation of Asian currencies precipitated by the drop in the value of the Thai baht created an extremely severe operating environment. However, its wide-ranging activities in Asia helped NEC record increased sales in the region. Particularly strong contributors to this expansion were the sales of communications infrastructure equipment in China. >> During the year under review, NEC strengthened its strategic alliances in China by establishing a semiconductor manufacturing joint venture company in Shanghai and by signing an agreement to establish a joint venture for semiconductor design in Beijing. In addition, NEC increased its assembly capacities at its semiconductor plants in Singapore, Malaysia, and Indonesia. Also, NEC established a subsidiary for the manufacture and sale of digital switching systems in Vietnam, a country with significant latent demand. >> NEC is promoting multimedia business in Asian countries. In Hong Kong, where a commercial interactive TV service was launched in March 1998, NEC delivered both leading-edge infrastructure equipment and set-top boxes (STBs). Furthermore, NEC won an order for a trial system of multimedia on demand in Guangdong, China. In Taiwan, NEC was awarded an order for an intracompany network project from a major convenience store

Highlights of the Year

- ■ Production of electronic components begins in the Philippines
- ■ NEC expands Russian communications systems business
- ■ Semiconductor production capacity increased at NEC's plant in Scotland
- ■ Orders received for CDMA systems in Brazil
- ■ NEC posts strong sales of PBXs in the United States
- ■ New orders for supercomputers are favorable
- ■ NEC's LCD monitors are well received in Europe
- ■ NEC receives order for automated postal processing systems in Taiwan
- □ NEC begins display monitor production in Mexico
- □ Strategic tie-ups formed with major European companies

NEC Receives Order for Automated Postal Processing Systems in Taiwan

NEC is working to expand its automated postal processing systems business in overseas markets. In fiscal 1998, NEC received a large order for such systems in Taiwan, covering five major cities of the country. NEC's systems integration capabilities, in addition to its advanced mail processing technologies, was the key to winning the order.

NEC Starts Production of Electronic Components in the Philippines

During the year under review, a plant of NEC Components Philippines, Inc., was brought on stream. The plant manufactures advanced printed wiring boards (PWBs) and relays for car electronics. This plant stresses environmental protection and includes facilities to recycle refuse and process wastewater.

chain. NEC will build and operate the system for this project. >> In Oceania, NEC posted strong sales of cellular phones and supercomputers. Also, NEC strengthened its server and systems integration businesses in Australia.

NORTH AMERICA

The U.S. economy continued to expand during the year under review; however, NEC's sales in North America declined despite higher sales of memory devices, color LCDs, and private branch exchanges (PBXs). This decline was due to lower sales of analog cellular phones and the July 1996 transfer of NEC's overseas PC business to Packard Bell NEC, an unconsolidated affiliated company. >> During fiscal 1998, NEC continued to reinforce its local product development capabilities and was successful in developing TDMA (time division multiple access) digital cellular phones for the U.S. market as well as microcomputers for use in communications equipment. >> To keep abreast of new markets and emerging technologies and apply this knowledge effectively into NEC's business, NEC established a corporate venture capital fund in the United States. Through this fund, NEC invested in several venture companies with unique technologies and services in such fields as the Internet and digital cellular phones.

LATIN AMERICA

Investment in communications infrastructure has been brisk in Latin America. During fiscal 1998, NEC do Brasil S.A., an affiliate in Brazil, recorded a sharp gain in shipments of cellular phone systems and won an order for digital switching systems. In addition, NEC de Colombia S.A.

NEC Enjoying Healthy Orders for Supercomputers

Sales of NEC's supercomputers were healthy in fiscal 1998. NEC delivered an SX-4 supercomputer to the Australian Bureau of Meteorology. The SX-4 will be used by the bureau and the Commonwealth Scientific and Industrial Research Organization (CSIRO) to make weather forecasts, study meteorological phenomena, and conduct medical research.

NEC also received new orders from the United Kingdom, the Czech Republic, France, and Germany.

NEC Posts Strong Sales of PBXs in the United States

Fueled by the introduction of NEAX2400IMS-IMX (Integrated Multimedia eXchange), sales of PBXs grew in the United States. NEC has gained market share in the highly competitive U.S. PBX market by applying its systems integration capabilities and thanks to the NEAX2400IMS-IMX's enhanced network software and hardware designed to meet current customer demands and emerging intranet, extranet, and Internet access requirements.

NEC Receives Orders for CDMA Systems in Brazil

NEC's analog cellular system commands a market share of more than 30 percent in Brazil. During the year under review, NEC, through its local affiliate NEC do Brasil, received an order from TELEBAHIA, a cellular operator in Brazil, for a CDMA system. In April 1998, NEC also received orders for such systems from operators in São Paulo and Rio de Janeiro.

received major orders for digital switching systems and SDH FOTS's. >> Furthermore, NEC do Brasil began the assembly of memory modules in response to Brazil's growing PC market. NEC strengthened its business in Argentina by making its affiliate there a wholly owned subsidiary. >> NEC established Multivisual NEC de Mexico, S.A. de C.V. for the production of display monitors to bolster its cost-competitiveness.

EUROPE

The European economies continued to recover and supported healthy NEC sales in the region. Communications infrastructure equipment, microcomputers, display monitors, and color LCDs were among the products that sold well in Europe. To ensure that its technologies are compliant with European communications standards, NEC fortified its R&D network in Europe with the addition of a research facility in Heidelberg, Germany. Furthermore, we have formed a partnership with Philips Semiconductors, of the Netherlands, in the field of SOCs for digital consumer products; with THOMSON multimedia, of France, in the color PDPs field; and with BULL, of France, in the supercomputers and PC servers fields.

THE MIDDLE AND NEAR EAST AND AFRICA

NEC delivered digital switching systems and microwave transmission systems in Egypt that contributed to a national project aimed at increasing the number of telephone subscribers in the upper Nile region. Also, in Morocco a digital radio multiple-access subscriber system (DRMASS) delivered by NEC became operational.

Large Orders Received for LCD Monitors from Major European Banks

NEC received large orders for its LCD2000 20-inch TFT color LCD monitors from major European banks. These large-screen, high-resolution LCD monitors are known for their wide-angle view, made possible through NEC's superfine technologies.

NEC's Communications Systems Business Expanding in Russia

Expected to expand rapidly in the future, the communications industry in Russia is a key market for NEC. During fiscal 1998, NEC established a joint venture company for switching systems in St. Petersburg. NEC won a contract to supply switching systems and FOTS's to St. Petersburg and several orders for switching systems from Moscow and other major cities. NEC also received orders in Russia for very small aperture terminals (VSATs) from government organizations and private-sector companies.

Semiconductor Production Capacity Increased in Scotland

Responding to an uptrend in demand for advanced 64Mbit DRAMs and logic ICs, NEC expanded its production capacity at its plant in Scotland. This plant will be a strategic base in NEC's semiconductor business.

Q What is NEC's approach to its SOC (system on a chip) business?

A SOC refers to integrating multiple functions onto a single chip. NEC's strengths in the SOC business are its extensive library of cores to realize multimedia functions and its cutting-edge semiconductor technologies both in memories and logic ICs. To work closely with its customers, NEC has established design centers in its major markets of Japan, the United States, Europe, and elsewhere in Asia. Through the provision of comprehensive solutions, NEC has built long-standing partnerships with leading equipment manufacturers in various industries worldwide. By leveraging its unique strengths, NEC aims to aggressively expand its SOC business and thus increase both sales and profits in its semiconductor business.

In fiscal 1998, sales of electron devices increased 3 percent, to ¥988.8 billion ($7,434 million), accounting for 20 percent of net sales. Although oversupply caused a weak performance in the DRAM market, NEC's semiconductor sales rose on the strength of sustained growth in the system LSI market associated with the further digitization of electronic equipment. Driven by demand for color LCDs, sales of electronic components also grew.

>> In **memories**, NEC accelerated its production shift from 16Mbit DRAMs to high-value-added 64Mbit DRAMs. Furthermore, NEC developed a 128Mbit synchronous DRAM mainly for use in notebook PCs and PC servers. NEC's total memory sales decreased owing to plunging prices for DRAMs; however, NEC enjoyed increased sales of high-speed static random access memories (SRAMs).

>> The **system LSI** market sustained its pattern of growth, reflecting the increasing digitization and multimedia integration of electronic equipment. Microcomputer sales advanced, thanks to demand from manufacturers of consumer electronics products and video game units. Supported by solid world demand for PCs and video game units, sales of application-specific integrated circuits (ASICs) increased. Sales of digital signal processors (DSPs) for cellular phones and charge-coupled devices (CCDs) were also higher.

>> During fiscal 1998, NEC signed an agreement with Philips Semiconductors B.V., of the Netherlands, to jointly develop SOCs. Under the agreement, NEC will provide its MIPS-based microprocessor core and both companies will combine their circuit libraries to jointly develop advanced SOCs for the rapidly growing field of digital consumer products.

>> Shipments of NEC's **discrete devices** rose with the launch of new products for cellular phones.

>> In response to rising demand for advanced semiconductors, NEC increased its production capacity of 0.25-micron diffusion lines in Japan, the United Kingdom, and the United States. In addition, participating in a Chinese government national project, NEC established a joint venture for semiconductor production with a local partner company.

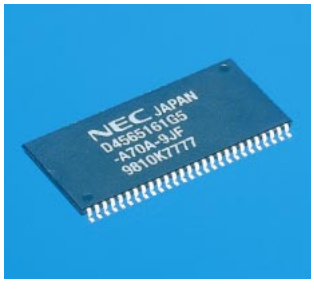
>> Despite a sluggish market for color LCDs for use in notebook PCs, sales of **thin-film transistor (TFT) color LCDs** increased due mainly to growing demand for panels for use in PC display monitors. Furthermore, NEC developed large 18.1-inch and 20.3-inch panels during the year under review. To capitalize on opportunities in the high-growth-potential area of **color PDPs**, NEC continued the construction of a mass-production plant in Japan and developed 42-inch and 50-inch modules.

Highlights of the Year

- ☐ Joint venture semiconductor company established in China
- ■ Development of cylindrical lithium-ion rechargeable battery
- ■ V_R4111, a microprocessor for hand-held PCs, developed
- ☐ Codevelopment agreement concluded with Philips Semiconductors for SOCs
- ■ VCM, a new memory technology, developed
- ■ 1/2-inch, 1.3-million-pixel CCD sensor developed
- ■ Strategic partnership with THOMSON multimedia for color PDPs formed
- ☐ 128Mbit synchronous DRAM developed

NEC Develops VCM Technology

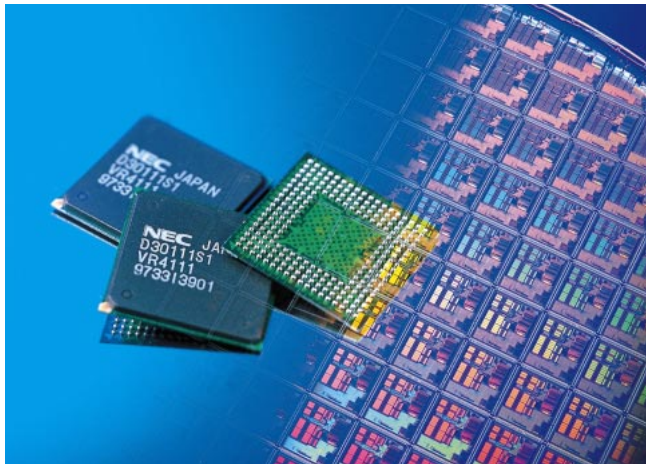
In November 1997, NEC unveiled virtual channel memory (VCM), a memory core technology that helps significantly enhance the system and graphic performances of PCs and workstations. VCM produces accelerated data input and output by introducing multiple channels for temporary memory storage between the memory cell and input/output interfaces.



NEC aims to establish VCM as the de facto standard for memory design. This new technology was adopted in a 64Mbit synchronous DRAM developed by NEC.

NEC Develops V_R4111 Microprocessor

NEC developed the V_R4111, a high-speed, 64-bit RISC microprocessor for hand-held PCs running Microsoft Corporation's Windows® CE 2.0 platform. Based on architecture developed by MIPS Technologies, of the United States, the V_R4111 was built using a leading-edge 0.25-micron process technology to offer high-speed processing with higher energy efficiency. The result is a twofold improvement in processing speed per unit of power consumption compared with its predecessor.



1/2-Inch, 1.3-Million-Pixel CCD Sensor Developed

CCD sensors are indispensable for image recognition in digital cameras. During fiscal 1998, NEC released a CCD sensor that integrates 1.3 million pixels in a 1/2-inch image size. This CCD sensor will help reduce power consumption and costs in high-resolution digital still cameras.

Strategic Partnership with THOMSON multimedia for Color PDPs

NEC has agreed with THOMSON multimedia S.A., of France, to develop next-generation technologies for

color PDPs. By developing next-generation circuitry and process technologies, the companies seek to create color PDPs that are brighter, more power-efficient, and have higher picture quality at a lower cost.

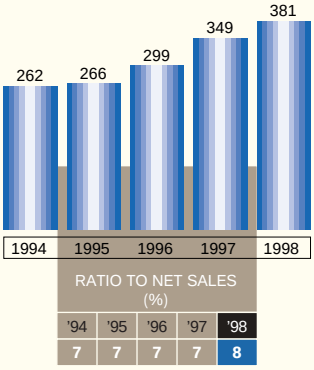
In addition, NEC will expand its global sales channels in this area by supplying 42-inch PDPs to THOMSON multimedia.

Development of Cylindrical Lithium-Ion Rechargeable Battery

NEC's affiliate Moli Energy (1990) Limited, of Canada, developed a cylindrical lithium-ion rechargeable battery using manganese materials in the electrode. Manganese-based materials cost less and are safer than the cobalt-based materials most commonly used in today's lithium-ion batteries. The newly developed battery is suitable for use in portable information terminals and will be sold through NEC's potent global channels.

The mission of NEC's R&D activities is to develop breakthrough technologies that contribute to the foundation of new businesses in the 21st century and leading-edge technologies that support existing businesses. During fiscal 1998, NEC focused its R&D activities on the following fields: multimedia data transmission, ultra-large-capacity WDM networks, natural user interfaces (NUIs), compound semiconductor devices for next-generation communications networks, sub-0.1-micron CMOS process technologies, and nanometer-class materials and semiconductors.

R&D EXPENSES (Billion ¥)



>> In the realm of software engineering, NEC emphasized research on object technologies, Internet protocol, WebComputing—highly reliable enterprise information systems using Internet technologies in combination with distributed object technologies—and integrated and multimedia software technologies. In production engineering, NEC achieved significant advances in design and production information systems, innovative manufacturing processes and equipment, mechatronics applications, high-density semiconductor packaging, and environmental technologies.

>> NEC opened the Kansai Research Laboratories in western Japan to further strengthen its R&D activities for multimedia applications and NUIs. Moreover, NEC established its third C&C Research Laboratories in Europe, in Heidelberg, Germany, to develop technologies for multimedia communications protocols and middleware.

Highlights of the Year

- Cenju-4 parallel processing computer developed
- Ultra-large-capacity optical access technology developed
- Research laboratories opened in Japan and Germany
- World's smallest MOS transistor with 14-nanometer gate length developed
- Assembly technology for communications-use SMT optical modules developed
- High-performance HJFET for cellular phones developed
- HOLON/VP used to develop new system for major convenience store chain

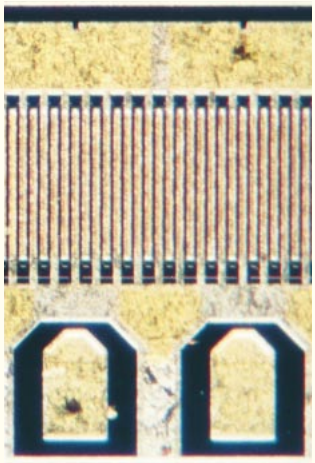
NEC Develops Cenju-4 Parallel Processing Computer

Parallel processing computers link multiple CPUs (central processing units) in a network configuration to distribute processing tasks and thus enhance processing performance. These computers are suited to semiconductor circuit design, the analysis of molecular structure, and other applications that require sophisticated scientific calculations.

NEC developed the Cenju-4 parallel processing computer based on an innovative memory architecture that integrates distributed and shared memory and message communications architectures. Cenju-4's architecture allows processors to share memory across multiple CPUs, and thus large amounts of data can be processed at high speeds.

High-Performance HJFET for Cellular Phones Developed

NEC developed a double-doped heterojunction field effect transistor (HJFET) that supports the extended battery life of cellular phones. By incorporating a novel multilayer cap and narrow recessed structure, the transistor achieves the world's highest-power-added efficiency of 64 percent when used as a high-output power transistor for digital cellular phones running on one lithium-ion rechargeable battery. Furthermore, the transistor features single-voltage operation, which simplifies circuitry design in cellular phones and thus lowers costs.



Ultra-Large-Capacity Optical Access Technology Developed

The linking of optical fibers to the home and the development of high-speed optical terminals are necessary to meet the increasing demand for the use of multimedia information through such networks as the Internet. In fiscal 1998, NEC developed a compact and inexpensive optical network unit (ONU) that can receive large volumes of data—equivalent to 20,000 telephone lines or 400 video channels.

Furthermore, NEC developed wireless transmission technology that helps create wireless multimedia home networks. Using this new technology, transmission equipment spaced 10 meters apart can transmit multimedia information at a speed of 100Mbits per second.

NEC Develops Innovative Assembly Technology for Communications-Use SMT Optical Modules

Optical modules are a key device for optical communications equipment that converts optical signals to electrical signals.

During the year under review, NEC developed the technology for an innovative surface mountable type (SMT) optical module. This technology uses optical element passive-alignment technology that obviates the need for adjustments to the optical axes during assembly and contributes to reducing module manufacturing costs and module dimensions.

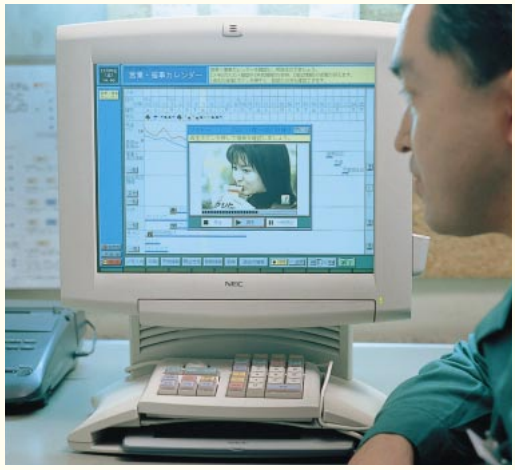
NEC Develops World's Smallest MOS Transistor with 14-Nanometer Gate Length

NEC developed and successfully operated the world's smallest metal oxide semiconductor (MOS) transistor, with a gate length of 14 nanometers (1 nanometer=1 millionth of a millimeter).

In addition, NEC has identified changes in electrical characteristics associated with size reduction in transistor geometries, thus establishing a solid foothold in the development of 10 terabit (10 trillion bits) memory devices. As the reduction in the gate length of transistors is thought to interfere with the normal operation of elements, research into the physical phenomena attributable to miniaturization is essential to enhancing the level of integration in semiconductor devices.

HOLON/VP Used to Develop New System for Major Convenience Store Chain

A new store management system, which was developed using NEC's innovative visual programming software HOLON/VP became operational at a major convenience store chain in Japan during the year under review. This strategic information system uses satellite communications to transmit large volumes of multimedia data and has been designed to be user friendly and able to operate 24 hours a day.



Compatible with the Windows NT® and Windows® 95 operating systems, NEC's HOLON/VP is a practical, general-use visual programming tool based on object-oriented technologies.

As we stand on the threshold of the 21st century, the preservation of the earth's environment has become an issue that demands the collective efforts of all humankind. NEC, realizing the need to maintain the delicate balance of nature, is dedicated to protecting the global environment in every area of its corporate activities. In addition, as a good corporate citizen, NEC endeavors to help communities grow and people live more prosperous lives. To these ends, NEC activities relating to social contributions focus on five specific areas: volunteer work; environmental preservation; social welfare activities; community involvement; and the arts, culture, and sports.

Major Activities of the Year

- Efforts to attain ISO14001 environmental certification continued
- Program to procure environment-friendly "green" products initiated
- Mercury-free external-electrode lamp developed
- Recycling of computer components promoted
- El Niño's effects analyzed with NEC's supercomputer
- Children's nature camp sponsored
- Satellite tracking study of sea eagle migratory patterns initiated
- NEC Guide Dog Project launched
- World Youth Choir featured at NEC Super Tower Concert
- Support for NEC Early Music Series started

Efforts to Attain ISO14001 Environmental Certification Continued

NEC has devoted its efforts to building environmental management systems and is continuously improving its business activities to qualify for ISO14001 certification, the International Organization for Standardization's set of standards relating to environmental management systems. As of March 1998, all NEC's domestic R&D and manufacturing facilities and six of its overseas manufacturing companies had received ISO14001 certifications.

Through its efforts to further strengthen its environmental management systems, NEC aims to achieve ISO14001 approval for all its domestic service companies by April 2000 and for all its overseas manufacturing companies by October 2000.

NEC Initiates Program to Procure Environment-Friendly "Green" Products

In June 1997, NEC began a program that places priority on the procurement of parts for manufacturing and office supplies that are environment friendly, or green. In fiscal 1998, about 30 percent of NEC's office supplies by type were green, and NEC plans to expand this program across the worldwide NEC Group.

Mercury-Free External-Electrode Lamp Developed

As one example of product development activities that put the welfare of the environment first, the NEC lamps that are used in color image scanners produced by a major U.S. computer manufacturer no longer contain mercury. Instead, the lamps use xenon gas for discharge, a substance with minimal environmental impact.

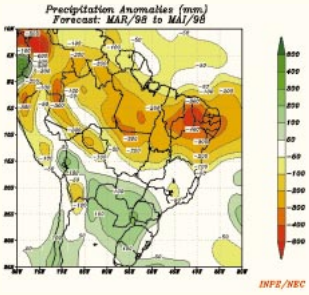
Recycling of Computer Components Promoted

Through the years, NEC has been recycling used computer components collected from corporate users, and in fiscal 1998 nearly 90 percent of the products by weight NEC collected were recycled. By continuing to disassemble products and sort them into reusable parts for repair as well as into steel and other materials for recycling, NEC aims to push this figure even higher. NEC's environmental management activities cover every stage of the product's life cycle, from parts procurement through disposal and recycling.

El Niño's Effects Analyzed with NEC's Supercomputer

NEC was entrusted by the Center of Weather Forecasting and Climates Studies of Brazil with predicting the effects of El Niño on the climate of South America.

Such enormous amounts of data as 30 years worth of average rainfall and air temperature measurements were analyzed with NEC's SX-4 supercomputer. The predictions of El Niño's effects on the climate of South America are being used for agricultural and other purposes in these regions.



Satellite Tracking Study of Sea Eagle Migratory Patterns Initiated

NEC supports environmental preservation activities to ensure that future generations may live in a world abundant with nature, sparkling water, and clean air. In 1997, NEC teamed up with the Wild Bird Society of Japan to study by use of satellites the migratory patterns of sea eagles, which are threatened with extinction.

Besides gaining valuable information about the eagles' yearly movements, under this project NEC provides computer simulations to help researchers better understand sea eagles' behavior and thus aid their survival.

World Youth Choir Featured at NEC Super Tower Concert

As part of its community involvement program, NEC invites local residents and people with disabilities to its Super Tower concerts. At these events, NEC personnel volunteer to assist the physically challenged. In fiscal 1998, the Super Tower Concert, which was performed at the NEC head office building, featured the World Youth Choir, an assembly of more than 80 gifted young vocalists from around the world.

NEC Sponsors Children's Nature Camp

In August 1997, NEC sponsored the Children's Nature Camp, a camp where children from foster homes can experience nature, outdoor cooking, and the joy of teamwork with their peers. NEC volunteers assisted the children at the camp.

NEC Guide Dog Project Launched

In the area of social welfare, in October 1997 NEC launched the Guide Dog Project. Despite the exemplary service these dogs provide to the visually impaired in terms of companionship and support, in Japan there is a severe shortage of guide dogs as well as a lack of understanding of their role in society. NEC's program helps fund the training of these guide dogs and contributes to the better understanding of guide dogs.

NEC Starts Support for Early Music Series

For a number of years, NEC has participated in a variety of activities to support the Boston Symphony Orchestra and other cultural organizations.

In fiscal 1998, NEC introduced the NEC Early Music Series to its list of cultural programs. This new program contributes to such associations as the Bach Collegium Japan, whose performances have included a series of cantatas composed by Johann Sebastian Bach.

Financial Section

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Eleven-Year Summary

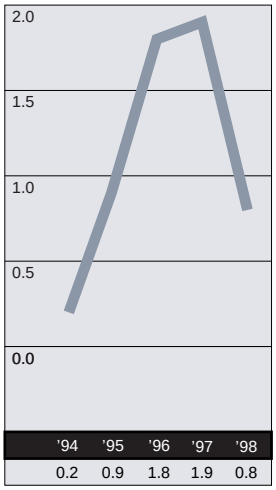
	In millions of yen				
	1988	1989	1990	1991	1992
For the fiscal year:					
Sales and other income	¥2,755,217	¥3,126,764	¥3,504,308	¥3,768,946	¥3,851,579
Net sales	2,714,736	3,082,800	3,444,177	3,698,798	3,773,850
Operating income	112,835	184,811	233,375	214,547	121,448
Income (loss) before income taxes	72,050	132,190	173,741	134,189	51,445
Income taxes	50,844	87,264	105,567	87,166	45,599
Net income (loss)	25,363	64,477	85,219	54,383	15,276
Capital expenditures	249,987	285,726	343,778	356,731	321,727
Depreciation	162,407	171,899	199,062	231,192	235,646
R&D expenses	208,067	221,607	246,544	279,483	302,363
Per share data (in yen and U.S. dollars):					
Per share of common stock:					
Net income (loss)					
Basic	17.60	43.85	56.47	35.45	9.93
Diluted	17.34	40.91	52.70	34.02	9.93
Cash dividends	9.00	9.00	10.00	10.00	10.00
Per American Depositary Share, each representing 5 shares of common stock:					
Net income (loss)					
Basic	88	219	282	177	50
Diluted	87	205	264	170	50
Cash dividends	45	45	50	50	50
At year-end:					
Total assets	2,904,928	3,346,412	3,683,999	3,929,533	4,081,217
Shareholders' equity	593,218	689,361	805,185	880,936	878,353
Employees	102,452	104,022	114,599	117,994	128,320

Note: U.S. dollar amounts are translated from yen, for convenience only, at the rate of ¥133=U.S.$1.

In millions of yen						In thousands of U.S. dollars
1993	1994	1995	1996	1997	**1998**	**1998**
¥3,583,552	¥3,652,501	¥3,829,538	¥4,427,272	¥5,064,872	**¥4,970,686**	**$37,373,579**
3,514,979	3,579,787	3,769,357	4,397,192	4,948,437	**4,901,122**	**36,850,541**
27,136	77,481	155,769	247,802	183,781	**190,404**	**1,431,609**
(37,692)	25,110	74,724	151,318	121,222	**90,993**	**684,158**
22,019	25,531	51,448	76,376	24,900	**48,033**	**361,150**
(45,160)	6,606	35,316	77,166	91,581	**41,302**	**310,541**
230,787	230,069	300,220	401,999	405,772	**385,346**	**2,897,338**
226,456	213,380	222,780	260,247	272,933	**285,862**	**2,149,338**
275,017	261,659	266,006	298,713	348,537	**381,239**	**2,866,459**
(29.34)	4.29	22.92	49.98	59.05	**25.94**	**0.195**
(29.34)	4.29	22.36	45.14	51.38	**24.05**	**0.181**
10.00	10.00	10.00	11.00	11.00	**11.00**	**0.083**
(147)	21	115	250	295	**130**	**0.98**
(147)	21	112	226	257	**120**	**0.90**
50	50	50	55	55	**55**	**0.41**
3,978,899	4,039,809	4,151,320	4,683,120	4,799,165	**4,973,836**	**37,397,263**
805,833	782,061	790,749	878,852	1,003,371	**1,070,757**	**8,050,805**
140,969	147,910	151,069	152,719	151,966	**152,450**	

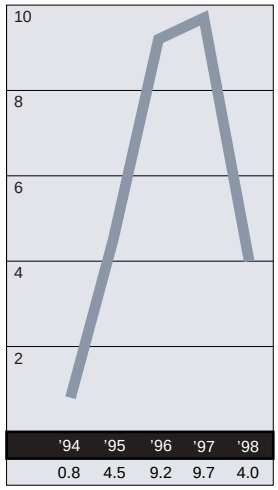
RETURN ON SALES

(%)



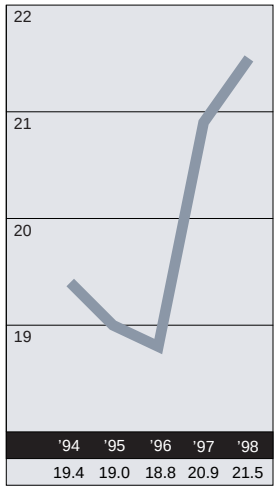
RETURN ON EQUITY

(%)



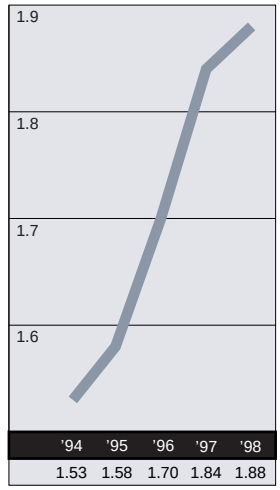
SHAREHOLDERS' EQUITY RATIO

(%)



CURRENT ASSET TURNOVER

(Times)



OPERATING RESULTS

Sales

Based on its concept of C&C, NEC is promoting primarily information/communications systems operations and electron devices operations. In fiscal 1998, ended March 31, 1998, consolidated net sales declined 1 percent, to ¥4,901.1 billion ($36,851 million).

By industry segment, **information/communications systems operations**, which comprise the manufacture and sale of communications systems and equipment and computers and industrial electronic systems, recorded a 2 percent decline in sales, to ¥3,694.5 billion ($27,778 million), due mainly to a drop in domestic sales of PCs. Of this segment, sales of communications systems and equipment rose 2 percent, to ¥1,717.3 billion ($12,912 million), reflecting higher overseas sales of infrastructure equipment for communications networks, which offset decreased domestic sales of mobile communications systems due to a leveling-off of the high-level infrastructure investment by communications carriers. In computers and industrial electronic systems, lower domestic sales of PCs and their peripheral equipment precipitated a 5 percent sales decline, to ¥1,977.2 billion ($14,866 million). **Electron devices operations** showed a 3 percent increase in sales, to ¥988.8 billion ($7,434 million), thanks to sales gains in system LSIs, such as microcomputers and ASICs. Sales of **others** decreased 1 percent, to ¥217.9 billion ($1,638 million).

On a consolidated basis, domestic sales fell 3 percent, to ¥3,737.0 billion ($28,098 million), as a consequence of weaker sales of communications systems and computers. Overseas sales advanced 5 percent, to ¥1,164.1 billion ($8,753 million), due to strong sales of communications systems as well as electron devices, such as 64Mbit DRAMs and microcomputers.

Operating Income

Operating income increased 4 percent, to ¥190.4 billion ($1,432 million), due mainly to cost-cutting activities, which led to a decline in the ratio of cost of sales to net sales compared with the previous period.

By industry segment, operating income of **information/communications systems operations** increased 1 percent, to ¥204.8 billion ($1,540 million), primarily owing to cost reduction within the operations. Operating income of **electron devices operations** decreased 1 percent, to ¥52.8 billion ($397 million). The decrease was mainly attributable to the sharp price erosion of memory devices despite increased sales of system LSIs. Operating loss from **others** decreased ¥3.2 billion ($24 million), to ¥1.1 billion ($8 million).

Net Income

Income before income taxes fell 25 percent, to ¥91.0 billion ($684 million), due to the restructuring of the hard disk drive business and the devaluation of shares of Packard Bell NEC, Inc., from the previous fiscal year, in which a considerable amount of gain from sales of marketable securities and land was realized. Net income declined 55 percent, to ¥41.3 billion ($311 million), over the previous term, in which tax burden was unusually low reflecting the devaluation of shares of NEC Home Electronics, Ltd., a wholly owned subsidiary.

As a result, diluted net income per share of common stock was ¥24.05 ($0.181) and diluted net income per American Depositary Share was ¥120 ($0.90).

Dividends

In fiscal 1998, cash dividends per share remained at ¥11.00 ($0.083), which included an interim dividend of ¥5.50 ($0.041) per share paid in December 1997.

INVESTMENT PROGRAMS

R&D Expenses

In further advancing its C&C business, NEC is actively engaged in the R&D of leading-edge technologies. During the fiscal year under review, R&D expenses increased 9 percent, to ¥381.2 billion ($2,866 million), accounting for 8 percent of net sales.

Capital Expenditures

In fiscal 1998, NEC's capital expenditures amounted to ¥385.3 billion ($2,897 million), a 5 percent decline from the previous year. During the term, we primarily invested in facilities mainly for the manufacture of semiconductors and color LCDs.

LIQUIDITY

Financial Position

At fiscal year-end, total assets were ¥4,973.8 billion ($37,397 million), a ¥174.7 billion ($1,313 million) increase from the previous fiscal year-end. Although current assets decreased because inventories showed a drop, total assets grew as a result of the increase in property, plant and equipment owing to the capital investment to expand production capacity of electron devices as well as the rise in long-term receivables and investments with additional investment in Packard Bell NEC, Inc. NEC's asset turnover ratio fell 0.04 percentage point, to 1.00.

Total liabilities rose ¥103.0 billion ($775 million), to ¥3,833.3 billion ($28,822 million). This rise in liabilities was attributable to an increase in long-term debt associated with the issuance of bonds and commercial paper. NEC procured such funds for fiscal 1998, ended March 31, 1998, as well as the subsequent fiscal year in light of the difficult conditions that Japan's financial system is currently facing.

As a result, the shareholders' equity ratio improved 0.6 percentage point over the previous fiscal year-end, to 21.5 percent.

Cash Flows

Net cash provided by operating activities increased ¥39.2 billion ($295 million) from the previous fiscal year, to ¥296.1 billion ($2,227 million). This was attributable to substantial decreases in the previous fiscal year of employees' savings deposits and notes and accounts payable, although net income decreased and notes and accounts receivable grew.

Net cash used in investing activities increased ¥45.9 billion ($345 million), to ¥513.6 billion ($3,862 million), due mainly to a drop in proceeds from sales of marketable securities.

Despite a reduction in short-term borrowings other than commercial paper, net cash provided by financing activities rose ¥11.6 billion ($88 million), to ¥186.5 billion ($1,402 million), primarily through the issuance of bonds and commercial paper.

As a result, cash and cash equivalents fell ¥31.5 billion ($237 million), to ¥319.0 billion ($2,398 million), at fiscal year-end.

Consolidated Subsidiaries

At the end of fiscal 1998, the number of consolidated subsidiaries stood at 131, an increase of three over the previous fiscal year-end. NEC Techno-Service, Ltd., a domestic subsidiary, and three overseas subsidiaries—NEC Argentina S.A., Netcomm Management Group, Inc., and Glens Falls Communications Corporation—were added, while a domestic subsidiary was eliminated through a merger.

SEGMENT INFORMATION (UNAUDITED)

The following segment information is prepared in accordance with the regulations under the Securities and Exchange Law of Japan.

Industry Segment Information

As of fiscal 1998, NEC has changed the classification of its business into information/communications systems operations, which include the manufacture and sale of communications systems and equipment and computers and industrial electronic systems; electron devices operations; and others, in consideration of such factors as the differences in product type, characteristics, and sales and manufacturing methods as well as core technologies. As the integration of communications systems and computers has accelerated with the advance of an information-intensive society and the expansion of network environments on a global scale, NEC has made this change to help the better understanding of its operations through the disclosure of the industry segment information.

	In millions of yen		In thousands of U.S. dollars (Note 3)
Year ended March 31	1997	**1998**	**1998**
Net sales			
Information/communications systems operations			
Unaffiliated customers	¥3,765,074	**¥3,694,488**	**$27,778,105**
Intersegment	54,448	**48,472**	**364,451**
Total	3,819,522	**3,742,960**	**28,142,556**
Electron devices operations			
Unaffiliated customers	963,176	**988,784**	**7,434,466**
Intersegment	114,076	**140,087**	**1,053,286**
Total	1,077,252	**1,128,871**	**8,487,752**
Others			
Unaffiliated customers	220,187	**217,850**	**1,637,970**
Intersegment	97,610	**94,901**	**713,541**
Total	317,797	**312,751**	**2,351,511**
Eliminations	(266,134)	**(283,460)**	**(2,131,278)**
Consolidated	¥4,948,437	**¥4,901,122**	**$36,850,541**
Operating profit (loss)			
Information/communications systems operations	¥ 203,407	**¥ 204,815**	**$ 1,539,962**
Electron devices operations	53,570	**52,769**	**396,759**
Others	(4,305)	**(1,062)**	**(7,984)**
Corporate expenses	(68,891)	**(66,118)**	**(497,128)**
Consolidated	¥ 183,781	**¥ 190,404**	**$ 1,431,609**
Assets			
Information/communications systems operations	¥2,410,852	**¥2,352,634**	**$17,688,977**
Electron devices operations	1,223,899	**1,322,544**	**9,943,940**
Others	436,273	**471,729**	**3,546,835**
Corporate and eliminations	728,141	**826,929**	**6,217,511**
Consolidated	¥4,799,165	**¥4,973,836**	**$37,397,263**
Depreciation and amortization			
Information/communications systems operations	¥ 77,781	**¥ 84,329**	**$ 634,053**
Electron devices operations	174,006	**177,503**	**1,334,609**
Others	3,991	**4,294**	**32,285**
Corporate and eliminations	17,452	**20,023**	**150,549**
Consolidated	¥ 273,230	**¥ 286,149**	**$ 2,151,496**
Capital expenditures (including intangible assets other than goodwill)			
Information/communications systems operations	¥ 132,070	**¥ 121,216**	**$ 911,398**
Electron devices operations	231,820	**231,286**	**1,738,992**
Others	8,882	**6,688**	**50,286**
Corporate and eliminations	34,225	**26,422**	**198,662**
Consolidated	¥ 406,997	**¥ 385,612**	**$ 2,899,338**

Notes: 1. Corporate expenses include general corporate expenses at the parent company and R&D expenses at the Central Research Laboratories.
2. Corporate assets include cash, deposits, securities and investment securities at the parent company, and property, plant and equipment of Headquarters and Central Research Laboratories.

Geographic Segment Information

Year ended March 31	In millions of yen 1997	In millions of yen **1998**	In thousands of U.S. dollars (Note 3) **1998**
Net sales			
Japan			
Unaffiliated customers	¥4,078,220	**¥4,048,556**	**$30,440,271**
Intersegment	446,772	**494,300**	**3,716,541**
Total	4,524,992	**4,542,856**	**34,156,812**
Overseas			
Unaffiliated customers	870,217	**852,566**	**6,410,270**
Intersegment	183,173	**166,680**	**1,253,233**
Total	1,053,390	**1,019,246**	**7,663,503**
Eliminations	(629,945)	**(660,980)**	**(4,969,774)**
Consolidated	¥4,948,437	**¥4,901,122**	**$36,850,541**
Operating profit (loss)			
Japan	¥ 184,373	**¥ 207,841**	**$ 1,562,714**
Overseas	3,724	**(13,693)**	**(102,955)**
Eliminations	(4,316)	**(3,744)**	**(28,150)**
Consolidated	¥ 183,781	**¥ 190,404**	**$ 1,431,609**
Assets			
Japan	¥4,159,919	**¥4,243,887**	**$31,908,925**
Overseas	758,485	**807,333**	**6,070,173**
Eliminations	(119,239)	**(77,384)**	**(581,835)**
Consolidated	¥4,799,165	**¥4,973,836**	**$37,397,263**

Sales by Market

Year ended March 31	In millions of yen 1997	In millions of yen **1998**	In thousands of U.S. dollars (Note 3) **1998**
Domestic			
Net sales	¥3,842,839	**¥3,737,029**	**$28,097,962**
Percent change	21%	**–3%**	
Percentage of net sales	78%	**76%**	
Overseas			
Net sales	¥1,105,598	**¥1,164,093**	**$ 8,752,579**
Percent change	–9%	**5%**	
Percentage of net sales	22%	**24%**	
Total			
Net sales	¥4,948,437	**¥4,901,122**	**$36,850,541**
Percent change	13%	**–1%**	
Percentage of net sales	100%	**100%**	

Consolidated Balance Sheets

NEC CORPORATION AND CONSOLIDATED SUBSIDIARIES
As of March 31, 1997 and 1998

	In millions of yen		In thousands of U.S. dollars (Note 3)
ASSETS	1997	**1998**	**1998**
Current assets:			
Cash and cash equivalents	¥ 350,494	**¥ 318,976**	**$ 2,398,316**
Marketable securities (Note 5)	108,943	**120,393**	**905,211**
Notes and accounts receivable, trade (Note 7)	1,152,585	**1,190,674**	**8,952,436**
Allowance for doubtful notes and accounts	(21,327)	**(12,075)**	**(90,789)**
Inventories (Note 6)	940,867	**865,033**	**6,504,008**
Deferred income taxes (Note 9)	38,215	**46,519**	**349,767**
Prepaid expenses and other current assets	57,256	**67,117**	**504,638**
Total current assets	2,627,033	**2,596,637**	**19,523,587**
Long-term receivables and investments:			
Marketable securities (Notes 5 and 7)	164,416	**167,854**	**1,262,060**
Investments and advances (Notes 4 and 5)—			
Affiliated companies	238,335	**289,326**	**2,175,383**
Other	107,826	**112,987**	**849,527**
Long-term receivables, trade (Note 7)	43,162	**40,111**	**301,586**
	553,739	**610,278**	**4,588,556**
Property, plant and equipment (Notes 7 and 16):			
Land	102,678	**111,267**	**836,594**
Buildings	883,248	**950,513**	**7,146,714**
Machinery and equipment	2,333,035	**2,399,260**	**18,039,549**
Construction in progress	65,112	**122,094**	**918,000**
	3,384,073	**3,583,134**	**26,940,857**
Accumulated depreciation	(2,043,477)	**(2,163,948)**	**(16,270,286)**
	1,340,596	**1,419,186**	**10,670,571**
Other assets:			
Deferred income taxes (Note 9)	74,877	**78,674**	**591,534**
Other	202,920	**269,061**	**2,023,015**
	277,797	**347,735**	**2,614,549**
	¥4,799,165	**¥4,973,836**	**$37,397,263**

The accompanying notes are an integral part of these statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	In millions of yen 1997	In millions of yen **1998**	In thousands of U.S. dollars (Note 3) **1998**
Current liabilities:			
Short-term borrowings (Note 7)	¥ 742,928	**¥ 801,913**	**$ 6,029,421**
Current portion of long-term debt (Note 7)	233,364	**218,205**	**1,640,639**
Notes and accounts payable, trade	947,163	**891,049**	**6,699,617**
Accrued taxes on income	10,818	**6,037**	**45,391**
Other current liabilities	417,694	**466,094**	**3,504,466**
Total current liabilities	2,351,967	**2,383,298**	**17,919,534**
Long-term liabilities:			
Long-term debt (Note 7)	1,069,210	**1,174,102**	**8,827,835**
Accrued pension and severance costs (Note 8)	205,353	**245,076**	**1,842,677**
Other	103,702	**30,787**	**231,480**
	1,378,265	**1,449,965**	**10,901,992**
Minority shareholders' equity in consolidated subsidiaries	65,562	**69,816**	**524,932**
Shareholders' equity (Note 10):			
Common stock, ¥50 par value—			
Authorized —3,200,000,000 shares			
Issued 1997 —1,565,653,924 shares	200,403	**—**	**—**
1998 —1,598,093,154 shares	—	**216,053**	**1,624,459**
Additional paid-in capital	312,192	**330,931**	**2,488,203**
Legal reserve	31,985	**34,081**	**256,248**
Retained earnings	455,205	**476,838**	**3,585,248**
Cumulative translation adjustments	3,601	**12,862**	**96,707**
	1,003,386	**1,070,765**	**8,050,865**
Treasury stock, at cost—			
1997—10,861 shares	(15)	**—**	**—**
1998— 5,882 shares	—	**(8)**	**(60)**
	1,003,371	**1,070,757**	**8,050,805**
Commitments and contingent liabilities (Note 17)			
	¥4,799,165	**¥4,973,836**	**$37,397,263**

Consolidated Statements of Income and Retained Earnings

NEC CORPORATION AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 1996, 1997 and 1998

	In millions of yen			In thousands of U.S. dollars (Note 3)
	1996	1997	**1998**	**1998**
Sales and other income:				
Net sales	¥4,397,192	¥4,948,437	**¥4,901,122**	**$36,850,541**
Interest, gain on securities sold, dividends and other (Notes 5 and 15)	30,080	116,435	**69,564**	**523,038**
	4,427,272	5,064,872	**4,970,686**	**37,373,579**
Costs and expenses:				
Cost of sales	2,980,718	3,528,326	**3,409,607**	**25,636,143**
Selling, general and administrative (Notes 13 and 14)	1,168,672	1,236,330	**1,301,111**	**9,782,789**
Interest	69,793	60,463	**61,257**	**460,579**
Other	56,771	118,531	**107,718**	**809,910**
	4,275,954	4,943,650	**4,879,693**	**36,689,421**
Income before income taxes	151,318	121,222	**90,993**	**684,158**
Income taxes (Note 9)	76,376	24,900	**48,033**	**361,150**
Income before minority interest and equity in earnings of affiliated companies	74,942	96,322	**42,960**	**323,008**
Minority interest in consolidated subsidiary companies	4,029	5,018	**2,839**	**21,346**
Income before equity in earnings of affiliated companies	70,913	91,304	**40,121**	**301,662**
Equity in earnings of affiliated companies (Note 4)	6,253	277	**1,181**	**8,879**
Net income	77,166	91,581	**41,302**	**310,541**
Retained earnings:				
Balance at beginning of year	324,704	382,901	**455,205**	**3,422,594**
Cash dividends applicable to earnings for the year	(17,000)	(17,118)	**(17,573)**	**(132,128)**
Transfer to legal reserve	(1,969)	(2,159)	**(2,096)**	**(15,759)**
Balance at end of year	¥ 382,901	¥ 455,205	**¥ 476,838**	**$ 3,585,248**

	Yen			U.S. dollars (Note 3)
	1996	1997	**1998**	**1998**
Net income per share of common stock (Note 11):				
Basic	¥49.98	¥59.05	**¥25.94**	**$0.195**
Diluted	45.14	51.38	**24.05**	**0.181**
Cash dividends per share	¥11.00	¥11.00	**¥11.00**	**$0.083**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

NEC CORPORATION AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 1996, 1997 and 1998

	In millions of yen			In thousands of U.S. dollars (Note 3)
	1996	1997	**1998**	**1998**
Cash flows from operating activities:				
Net income	¥ 77,166	¥ 91,581	**¥ 41,302**	**$ 310,541**
Adjustments to reconcile net income to net cash provided by operating activities—				
Depreciation	260,247	272,933	**285,862**	**2,149,338**
Deferred income taxes	(31,878)	(2,193)	**(11,073)**	**(83,256)**
Accrual for pension and severance costs, less payments	16,407	10,614	**(5,197)**	**(39,075)**
Equity in earnings of affiliated companies, net of dividends	(1,760)	12,514	**8,596**	**64,632**
Minority interest in consolidated subsidiary companies	4,029	5,018	**2,839**	**21,346**
(Increase) decrease in notes and accounts receivable	(174,871)	46,925	**(30,913)**	**(232,429)**
(Increase) decrease in inventories	(146,225)	126,946	**77,655**	**583,872**
Increase (decrease) in notes and accounts payable	296,144	(179,355)	**(54,706)**	**(411,323)**
Increase (decrease) in accrued taxes on income	15,774	(48,009)	**(3,885)**	**(29,210)**
Increase (decrease) in employees' savings deposits	5,333	(92,302)	**(3,914)**	**(29,428)**
Other, net	(36,568)	12,277	**(10,431)**	**(78,429)**
Net cash provided by operating activities	283,798	256,949	**296,135**	**2,226,579**
Cash flows from investing activities:				
Proceeds from sales of property, plant and equipment	12,394	40,072	**5,794**	**43,564**
Additions to property, plant and equipment	(341,907)	(452,109)	**(393,776)**	**(2,960,722)**
Proceeds from sales of marketable securities	11,506	118,259	**22,419**	**168,564**
Payments for purchase of marketable securities	(22,117)	(104,419)	**(46,606)**	**(350,421)**
Investments in affiliated companies	(22,367)	(71,064)	**(71,803)**	**(539,872)**
Disbursements for long-term loans	(16,067)	(5,694)	**(2,703)**	**(20,323)**
Decrease in long-term loans	19,349	10,236	**11,642**	**87,533**
Other, net	3,255	(2,981)	**(38,547)**	**(289,827)**
Net cash used in investing activities	(355,954)	(467,700)	**(513,580)**	**(3,861,504)**
Cash flows from financing activities:				
Proceeds from long-term debt	146,433	252,152	**360,892**	**2,713,474**
Repayment of long-term debt	(156,516)	(150,220)	**(167,762)**	**(1,261,368)**
Increase in short-term borrowings	26,644	91,252	**10,032**	**75,429**
Dividends paid	(15,426)	(17,782)	**(17,407)**	**(130,880)**
Other, net	(259)	(540)	**749**	**5,631**
Net cash provided by financing activities	876	174,862	**186,504**	**1,402,286**
Effect of exchange rate changes on cash and cash equivalents	6,238	5,378	**(577)**	**(4,338)**
Net decrease in cash and cash equivalents	(65,042)	(30,511)	**(31,518)**	**(236,977)**
Cash and cash equivalents at beginning of year	446,047	381,005	**350,494**	**2,635,293**
Cash and cash equivalents at end of year	¥381,005	¥350,494	**¥318,976**	**$2,398,316**
Supplemental disclosures of cash flow information:				
Cash paid during the year for—				
Interest	¥ 71,138	¥ 62,941	**¥ 61,412**	**$ 461,744**
Income taxes	¥ 87,780	¥ 71,399	**¥ 88,844**	**$ 668,000**
Supplemental information of noncash financing activities:				
Conversion of convertible debt into common stock and additional paid-in capital	¥ 4,568	¥ 19,326	**¥ 33,957**	**$ 255,316**

The accompanying notes are an integral part of these statements.

1 NATURE OF OPERATIONS

The company is primarily engaged in the development, manufacture and sale of information/communications systems—comprising communications systems and equipment and computers and industrial electronic systems—as well as electron devices. The company's principal business activities are based on the integration of computer and communications products and technology ("C&C"), supported by semiconductor and software technology. For the years ended March 31, 1996, 1997, and 1998, sales of information/communications systems operations accounted for 72 percent, 76 percent and 76 percent and sales of electron devices operations accounted for 24 percent, 20 percent and 20 percent of consolidated net sales, respectively. The company operates both in Japan and overseas, with manufacturing facilities in Japan, the United States of America, Europe, Asia, and other countries and sales offices in Japan and around the world. During the years ended March 31, 1996, 1997 and 1998, sales to customers in Japan were 72 percent, 78 percent and 76 percent of consolidated net sales, respectively. In these Notes, references to the "company" are (unless the context does not so permit) to the parent company and its consolidated subsidiaries.

2 SIGNIFICANT ACCOUNTING POLICIES

The parent company and its Japanese subsidiaries maintain their records and prepare their financial statements in accordance with accounting principles generally accepted in Japan, and its foreign subsidiaries in conformity with those of the countries of their domicile. Certain adjustments and reclassifications, including those relating to the tax effects of temporary differences, the accrual of certain expenses, and the accounting for foreign currency translation, lease transactions and common stock warrants have been incorporated in the accompanying consolidated financial statements to conform with accounting principles generally accepted in the United States of America. These adjustments were not recorded in the statutory books of account.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant accounting policies, after reflecting adjustments for the above, are as follows:

Basis of consolidation and investments in affiliated companies

The consolidated financial statements include those of the parent company and those of its majority-owned subsidiaries. All significant intercompany transactions and accounts are eliminated.

Investments in 50 percent or less owned companies over which the company does not have control, but has the ability to exercise significant influence, are accounted for by the equity method.

The excess of the cost over the underlying net equity of investments which have been revalued to fair value of assets and liabilities in consolidated companies and investments accounted for by the equity method is recognized as goodwill and is amortized on a straight-line basis over the period of expected benefit which does not exceed 10 years.

Cash equivalents

All highly liquid investments, including time deposits, with original maturities of three months or less are considered to be cash equivalents.

Foreign currency translation

Asset and liability accounts of foreign consolidated subsidiaries and equity investments are translated into yen at appropriate year-end rates of exchange and all revenue and expense accounts are translated at average rates of exchange prevailing during the year. The resulting translation adjustments are accumulated and reported as a component of shareholders' equity.

Marketable securities and other investments

The current and noncurrent portfolios of marketable equity securities are each carried at the lower of aggregate cost or market. Other marketable securities are carried at the lower of cost or market. Other investment securities are stated at cost or less. Realized gains or losses on the sale of marketable equity securities are based on the average cost of all of the shares of a particular security held at the time of sale. (See Note 5 to the consolidated financial statements for an explanation of the effects of not adopting the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115.)

Inventories

Inventories are stated at the lower of cost or market.

Finished products made to customer specifications are costed on the basis of accumulated production costs. Mass-produced standard products are principally costed on a first-in, first-out basis.

Work in process made to customer specifications represents accumulated production costs of job orders. Work in process of mass-produced standard products is stated on an average cost basis. The cost of semifinished components is principally determined on a first-in, first-out basis.

Raw materials and purchased components are principally stated on a first-in, first-out basis and, for certain subsidiaries, on an average cost method.

Effective April 1, 1997, the company changed its inventory costing method for other finished products, semifinished components, and raw materials and purchased components, principally from last-in, first-out basis to first-in, first-out basis. The company has recently been experiencing reductions in manufacturing cost through lower cost of purchased components and increased labor efficiency. The company believes that the first-in, first-out methodology is more representative of fair value of inventory. The effect of the change in accounting principle was not material to the financial position or results of operations.

Property, plant and equipment and depreciation

Property, plant and equipment is stated at cost. Depreciation is computed primarily on the declining-balance method and, for certain subsidiaries, on the straight-line method, at rates based on the following estimated useful lives of the assets: buildings, two to 65 years, machinery and equipment, two to 22 years. Maintenance and repairs, including minor renewals and betterments, are charged to income as incurred.

Income taxes

The provision for income taxes is based on the pretax income included in the consolidated statements of income and retained earnings and is computed under the asset and liability approach. Under this approach, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting basis and tax basis of assets and liabilities. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

Additional paid-in capital and free distributions of common stock

Under the Japanese Commercial Code, the entire amount of the issue price of shares is required to be accounted for in the common stock account although a company in Japan may, by a resolution of its board of directors, account for an amount not exceeding one-half of the issue price of the shares as additional paid-in capital.

The company in Japan has made, based on the resolution of the board of directors, a free distribution of shares to shareholders, which is clearly distinguished from a "stock dividend" paid out of profits that, under the Commercial Code, must be approved by the shareholders. In accounting for the free distribution of shares, the Commercial Code permitted the board of directors to authorize either (1) a transfer from additional paid-in capital to the common stock account or (2) no entry if free shares were distributed from the portion of previously issued shares accounted for as excess of par value in the common stock account. Companies in the United States of America issuing shares in amounts comparable to those of the free share distributions of the parent company would be required to account for them as stock dividends and the fair value of the shares would be transferred from retained earnings to appropriate capital accounts. Such transfer, however, has no effect on total shareholders' equity.

Net income per share

In the fiscal year ended March 31, 1998, the company adopted SFAS No. 128, “Earnings per Share” which requires dual presentation of basic net income per share (“EPS”) and diluted EPS on the face of the income statement for all entities with complex capital structures and requires a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. Basic EPS is computed by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. Diluted EPS assumes the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, or resulted in the issuance of common stock. All prior-period EPS data presented have been restated to conform with the provisions of this statement.

Sales

Sales of computers and certain types of major equipment are recorded when the units are installed and accepted by the customers, while sales of other equipment, components and appliances are recorded when completed units are shipped. The estimated accrued losses arising from estimated future returns of leased computers, and the related future tax benefit, are reflected in the financial statements.

Financial instruments

The company has entered into forward exchange contracts as hedges against the adverse impact of foreign currency fluctuations on monetary assets and liabilities arising from the company’s operations. Gains and losses on these contract hedges are deferred and included in the measurement of the related foreign currency transactions so that foreign exchange gains or losses on the underlying assets and liabilities could be effectively offset. Agreements that are, in substance, essentially the same as forward exchange contracts, such as currency swaps, are accounted for in a manner similar to the accounting for forward exchange contracts. The interest rate swap agreements are fully integrated with underlying debt obligations and designed to convert fixed rate debt into floating rate debt, or vice versa and interest rate option agreements are also arranged so that exposures to losses resulting from fluctuations in interest rates are managed. The differentials to be paid or received related to interest rate swap agreements are recognized in interest expense over the lives of the agreements. See Note 12 to the consolidated financial statements for detailed descriptions of these financial instruments.

Reclassifications

Certain accounts in the consolidated financial statements for the years ended March 31, 1996 and 1997 have been reclassified to conform to the 1998 presentation.

3 U.S. DOLLAR AMOUNTS

U.S. dollar amounts are included solely for the convenience of the readers of the financial statements. These translations should not be construed as representations that the yen amounts actually represent, or have been or could be converted into, U.S. dollars.

As the amounts shown in U.S. dollars are for convenience only, and are not intended to be computed in accordance with generally accepted translation procedures, the rate of ¥133=U.S.$1, the approximate current rate at March 31, 1998, has been used for the purpose of presentation of the U.S. dollar amounts in the accompanying consolidated financial statements.

4 INVESTMENTS IN AFFILIATED COMPANIES

The investees accounted for by the equity method together with a percentage of the company’s ownership of voting share are Nippon Electric Glass Co., Ltd. (42.2%), ANRITSU CORPORATION (26.9%), Toyo Communication Equipment Co., Ltd. (39.0%), NITSUKO CORPORATION (34.3%), Nippon Electric Industry Co., Ltd. (47.9%), Tokin Corporation (41.1%), NEC Leasing, Ltd. (50.0%), Sumitomo 3M Limited (25.0%), Packard Bell NEC, Inc. (“PBN”) (49.0%) and six other companies at March 31, 1998.

Summarized financial information relating to 50 percent or less owned companies accounted for under the equity method is as follows:

March 31	In millions of yen 1997	**1998**	In thousands of U.S. dollars **1998**
Current assets	¥1,025,055	**¥1,089,749**	**$8,193,602**
Other assets, including property, plant and equipment	1,014,442	**1,064,536**	**8,004,030**
Current liabilities	862,489	**937,307**	**7,047,421**
Long-term liabilities	699,000	**797,261**	**5,994,444**
Redeemable preferred stock	101,303	**150,597**	**1,132,308**

Year ended March 31	In millions of yen 1996	1997	**1998**	In thousands of U.S. dollars **1998**
Sales and operating revenue	¥1,342,154	¥1,715,434	**¥1,755,668***	**$13,200,511**
Net income (loss)	13,420	(34,797)	**(43,551)***	**(327,451)**

*Including the amounts related to PBN for 1998, ¥461,551 million ($3,470,308 thousand) and ¥(76,798) million ($577,429 thousand), respectively. The company recognized ¥15,320 million ($115,188 thousand) as equity loss.

Of the 15 companies at March 31, 1998 (16 companies at March 31, 1997) accounted for under the equity basis, the stocks of six companies carried at equity of ¥112,184 million and ¥115,384 million ($867,549 thousand) at March 31, 1997 and 1998, respectively, were quoted on the market at an aggregate value of ¥240,446 million and ¥201,449 million ($1,514,654 thousand), respectively, at those dates.

The balances and transactions with companies accounted for under the equity method are shown below:

March 31	In millions of yen 1997	**1998**	In thousands of U.S. dollars **1998**
Receivables, trade	¥66,814	**¥33,212**	**$249,714**
Payables, trade	52,929	**46,447**	**349,226**

Year ended March 31	In millions of yen 1996	1997	**1998**	In thousands of U.S. dollars **1998**
Sales	¥212,777	¥253,393	**¥257,170**	**$1,933,609**
Purchases	116,441	112,776	**117,016**	**879,820**

On August 31, 1995, for consideration of ¥17,026 million the company acquired 4,040,149 shares of voting convertible preferred stock of Packard Bell Electronics, Inc. (“PB”) representing 19.97% of the then combined outstanding common and preferred stock of PB.

On April 1, 1996, the company purchased 6,725,285 shares of non-voting redeemable convertible preferred stock from PB for ¥30,706 million. On June 30, 1996, the parent company, NEC Technologies, Inc., a wholly owned subsidiary, and PB effected an agreement to transfer certain assets and liabilities of the company’s personal computer business to PB in order to integrate their worldwide personal computer businesses, except in Japan and China. The company received 7,306,000 shares of non-voting redeemable convertible preferred stock of PB for ¥35,270 million consideration for the assets transferred. On July 11, 1996, PB changed its name to Packard Bell NEC, Inc. On June 30, 1997, the company purchased 6,772,814 shares of non-voting redeemable convertible preferred stock from PBN for ¥32,875 million ($247,180 thousand). On December 26, 1997 and February 6, 1998, the company purchased senior subordinated convertible notes for ¥19,725 million ($148,308 thousand) and ¥18,780 million ($141,203 thousand), respectively.

In February 1998, in connection with the note purchase, 11,445,000 shares of non-voting redeemable convertible preferred stock of PBN held by the company have been exchanged on a one-for-one basis for 11,445,000 shares of voting convertible preferred stock of PBN.

The preferred stock exchanged has been devalued to fair value and a loss of ¥10,663 million ($80,173 thousand) has been recognized on this exchange. The company also recognized a loss of ¥19,706 million ($148,165 thousand), relating to the devaluation of the investment. (See Note 5 to the consolidated financial statements.) After the exchange, the company's share of the outstanding voting shares of PBN has increased to 49% of the combined outstanding common and voting shares of PBN.

The non-voting redeemable convertible preferred stock is classified as debt securities based on the provisions of SFAS No. 115.

5 MARKETABLE AND INVESTMENT SECURITIES

At the request of the company and other Japanese companies which file their consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America, with the United States Securities and Exchange Commission (the "SEC") and the Japanese Ministry of Finance, in August 1993 the SEC issued a confirmation letter that the SEC would accept filings by the company and other Japanese companies that do not adopt the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," in their primary financial statements, but provide the information required by the provisions of SFAS No. 115 in a note to the financial statements. SFAS No. 115 addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. Under SFAS No. 115, certain investments in debt and equity securities are classified in the following three categories: held-to-maturity, trading or available-for-sale securities. Debt and equity securities classified as available-for-sale securities are reported at fair value, with unrealized gains and losses reported in a separate component of shareholders' equity, net of taxes.

The effects on the consolidated balance sheet accounts at March 31, 1997 and 1998 of the departure from the provisions of SFAS No. 115 are summarized as follows:

	In millions of yen		In thousands of U.S. dollars
March 31	1997	**1998**	**1998**
Shareholders' equity as reported	¥1,003,371	**¥1,070,757**	**$8,050,805**
Net increase in carrying amount of:			
Marketable and investment securities —Current	66,997	**41,321**	**310,684**
—Noncurrent	131,802	**113,677**	**854,714**
Net decrease in deferred tax assets and increase in deferred tax liabilities:			
Deferred tax assets —Current	9,655	**10,845**	**81,541**
—Noncurrent	330	**530**	**3,985**
Deferred tax liabilities —Current	(43,998)	**(30,292)**	**(227,759)**
—Noncurrent	(70,079)	**(56,332)**	**(423,549)**
Net increase in investments and advances—affiliated companies and other	8,411	**12,002**	**90,241**
Net increase in minority interest	(773)	**(221)**	**(1,662)**
Shareholders' equity in accordance with accounting principles generally accepted in the United States of America	¥1,105,716	**¥1,162,287**	**$8,739,000**

The following is a summary of marketable and investment securities by major security type:

March 31	In millions of yen							
	1997				**1998**			
	Carrying amount	Gross unrealized holding gains	Gross unrealized holding losses	Fair value	Carrying amount	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Current								
Available-for-sale:								
Equity securities	¥ 89,512	¥ 86,042	¥19,273	¥156,281	**¥ 99,856**	**¥ 64,214**	**¥23,130**	**¥140,940**
Debt securities	19,431	228	—	19,659	**20,537**	**237**	**—**	**20,774**
	¥108,943	¥ 86,270	¥19,273	¥175,940	**¥120,393**	**¥ 64,451**	**¥23,130**	**¥161,714**
Noncurrent								
Available-for-sale:								
Equity securities	¥138,212	¥128,138	¥ 941	¥265,409	**¥142,628**	**¥110,161**	**¥ 1,482**	**¥251,307**
Debt securities	92,180	4,605	—	96,785	**86,845**	**4,998**	**—**	**91,843**
	¥230,392	¥132,743	¥ 941	¥362,194	**¥229,473**	**¥115,159**	**¥ 1,482**	**¥343,150**

March 31	In thousands of U.S. dollars			
	1998			
	Carrying amount	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Current				
Available-for-sale:				
Equity securities	**$ 750,797**	**$482,812**	**$173,910**	**$1,059,699**
Debt securities	**154,414**	**1,782**	**—**	**156,196**
	$ 905,211	**$484,594**	**$173,910**	**$1,215,895**
Noncurrent				
Available-for-sale:				
Equity securities	**$1,072,391**	**$828,278**	**$ 11,143**	**$1,889,526**
Debt securities	**652,970**	**37,579**	**—**	**690,549**
	$1,725,361	**$865,857**	**$ 11,143**	**$2,580,075**

The net unrealized holding gains, net of taxes, on available-for-sale securities increased by ¥59,155 million for the year ended March 31, 1996 and decreased by ¥85,297 million and ¥10,815 million ($81,316 thousand) for the years ended March 31, 1997 and 1998, respectively.

Contractual maturities of available-for-sale debt securities at March 31, 1998 are in the period from April 1, 1998 to June 15, 2015.

Proceeds from sales of available-for-sale securities were ¥11,506 million, ¥118,259 million and ¥22,419 million ($168,564 thousand) for the years ended March 31, 1996, 1997 and 1998, respectively. Gross realized gains on those sales were ¥2,380 million, ¥52,137 million and ¥16,885 million ($126,955 thousand) for the years ended March 31, 1996, 1997 and 1998, respectively, and gross realized losses were ¥469 million, ¥194 million and ¥30,412 million ($228,662 thousand), including ¥10,663 million ($80,173 thousand) and ¥19,706 million ($148,165 thousand), relating to the investments in affiliated companies described in Note 4, for the years ended March 31, 1996, 1997 and 1998, respectively.

6 INVENTORIES

Inventories at March 31, 1997 and 1998 comprise the following:

March 31	In millions of yen		In thousands of U.S. dollars
	1997	**1998**	**1998**
Finished products	¥300,829	**¥296,352**	**$2,228,211**
Work in process and semifinished components	485,731	**434,866**	**3,269,669**
Less—Advance payments received	(30,988)	**(34,026)**	**(255,834)**
Raw materials and purchased components	185,295	**167,841**	**1,261,962**
	¥940,867	**¥865,033**	**$6,504,008**

7 SHORT-TERM BORROWINGS AND LONG-TERM DEBT

Short-term borrowings at March 31, 1997 and 1998 comprise the following:

March 31	In millions of yen 1997	In millions of yen **1998**	In thousands of U.S. dollars **1998**
Loans, principally from banks, including bank overdrafts (average interest rate of 2.20% at March 31, 1997 and 2.62% at March 31, 1998):			
Secured	¥ 2,282	**¥ 60,152**	**$ 452,271**
Unsecured	700,316	**612,131**	**4,602,489**
Commercial paper (interest rates of 5.23% to 5.90% at March 31, 1997 and 0.70% to 6.10% at March 31, 1998)	40,330	**129,630**	**974,661**
	¥742,928	**¥801,913**	**$6,029,421**

Long-term debt at March 31, 1997 and 1998 comprises the following:

March 31	In millions of yen 1997	In millions of yen **1998**	In thousands of U.S. dollars **1998**
Loans, principally from banks and insurance companies, due 1997 to 2010 with interest rates of 0.511% to 9.72% at March 31, 1997 and due 1998 to 2010 with interest rates of 0.705% to 9.72% at March 31, 1998:			
Secured	¥ 58,680	**¥ 42,416**	**$ 318,917**
Unsecured	451,632	**449,949**	**3,383,075**
5.6% to 7.15% at March 31, 1997 and 1998 unsecured yen bonds due 1997 to 2007 at March 31, 1997 and due 1998 to 2007 at March 31, 1998 issued in the Euromarket	160,000	**130,000**	**977,444**
2.45% to 3.3% at March 31, 1997 and 1.9% to 3.3% at March 31, 1998 unsecured yen debentures due 1997 to 2005 at March 31, 1997 and due 1999 to 2009 at March 31, 1998	120,000	**270,000**	**2,030,075**
Floating rate unsecured yen notes due 1997 and 1998 issued in the Euromarket	30,000	**—**	**—**
1.9% unsecured yen convertible debentures due 2004, convertible currently at ¥1,962.90 for one common share, redeemable before due date	118,527	**118,522**	**891,143**
1.0% unsecured yen convertible debentures due 2011, convertible currently at ¥1,375.00 for one common share, redeemable before due date	99,977	**99,460**	**747,820**
1.8% unsecured yen convertible debentures due 2002, convertible currently at ¥2,066.80 for one common share, redeemable before due date	95,042	**95,041**	**714,594**
1.9% unsecured yen convertible debentures due 2001, convertible currently at ¥976.00 for one common share, redeemable before due date	30,343	**27,412**	**206,105**
1.7% unsecured yen convertible debentures due 1999, convertible currently at ¥976.00 for one common share, redeemable before due date	26,180	**21,796**	**163,880**
2.1% unsecured yen convertible debentures due 1998, convertible currently at ¥1,414.10 for one common share, redeemable before due date	19,540	**19,515**	**146,729**
1.0% unsecured Swiss Francs convertible notes (Swiss Francs 383,350 thousand—1997 and Swiss Francs 81,350 thousand—1998) due 1999, convertible currently at ¥976.00 for one common share, redeemable before due date	33,117	**7,131**	**53,616**
0.375% unsecured yen convertible notes issued by a consolidated subsidiary due 2002	—	**12,000**	**90,226**
0.2% to 1.6% yen medium-term notes issued by a consolidated subsidiary due 1999 to 2001 (swapped for LIBOR related Sterling Pound obligation)	—	**29,121**	**218,955**
Long-term capital lease obligation, due 1997 to 2003 with interest rates of 2.5% to 8.0% at March 31, 1997 and due 1998 to 2003 with interest rates of 2.3% to 8.4% at March 31, 1998	55,397	**67,780**	**509,624**
Other	3,459	**1,756**	**13,203**
	1,301,894	**1,391,899**	**10,465,406**
Unamortized premium	680	**408**	**3,068**
	1,302,574	**1,392,307**	**10,468,474**
Less—Portion due within one year	233,364	**218,205**	**1,640,639**
	¥1,069,210	**¥1,174,102**	**$ 8,827,835**

The following are pledged as security for short-term borrowings and long-term debt at March 31, 1998:

Description	In millions of yen	In thousands of U.S. dollars
Current notes and accounts receivable	¥ 63,633	$ 478,444
Marketable securities—Noncurrent	49	368
Long-term receivables, trade	6,563	49,346
Property, plant and equipment (net book value)	161,586	1,214,932

Floating rate unsecured yen notes issued in the Euromarket comprise three notes each of ¥10,000 million. The interest rates thereon in the particular interest period are 0.1 percent, 0.25 percent and 0.375 percent above the three-month Euro-yen deposit rate in the London interbank market as defined in the agreements.

The 2.1 percent and 1.8 percent unsecured yen convertible debenture agreements stipulate, among other things, that (1) the parent company is required to deposit with a designated bank, as a sinking fund payment, amounts adjusted for redemptions and conversions made to the dates specified in the agreements and (2) certain restrictions are placed on the payment of dividends. Under the agreements the parent company deposited, instead of the cash, marketable securities amounting to ¥11,844 million and ¥30,318 million ($227,955 thousand) at March 31, 1997 and 1998, respectively.

The agreement of the 1.9 percent unsecured yen convertible debentures due 2004 stipulates, among other things, that the parent company is required to deposit with a designated bank, as a sinking fund payment, amounts adjusted for redemptions and conversions made to the dates specified in the agreement.

The sinking fund payments, adjusted for the conversions made to March 31, 1998, are as follows:

	Sinking fund payments		
		Amount of each payment	
Convertible debentures	Date	In millions of yen	In thousands of U.S. dollars
1.8%	March 31, 1999, 2000 and 2001	¥12,000	$ 90,226
1.9%	March 31, 1999 and 2000	10,000	75,188
	March 31, 2001, 2002 and 2003	14,000	105,263

At March 31, 1998, an aggregate of 250,060 thousand shares of common stock would have been issuable upon conversion of all convertible debt of the parent company.

The company has basic agreements with lending banks to the effect that, with respect to all present or future loans with such banks, the company shall provide collateral (including sums on deposit with such banks) or guarantors therefor immediately upon the bank's request and that any collateral furnished, pursuant to such agreements or otherwise, will be applicable to all indebtedness to such banks.

Certain of the loan agreements provide, among other things, that the company submits to the lenders (upon their request) for approval its proposed appropriation of income (including dividends) before such appropriation can be submitted to the shareholders for approval.

Annual maturities and sinking fund requirements on long-term debt during the five years ending March 31, 2003 are as follows:

Year ending March 31	In millions of yen	In thousands of U.S. dollars
1999	¥240,205	$1,806,053
2000	249,075	1,872,744
2001	221,305	1,663,947
2002	186,563	1,402,729
2003	160,279	1,205,105

8 PENSION AND SEVERANCE PLANS

The parent company and subsidiaries in Japan have severance indemnity plans and non-contributory defined benefit funded pension plans, or only severance indemnity plans, covering substantially all of their employees who meet eligibility requirements of the retirement regulations. Under the plans, employees whose service with the company is terminated are, under most circumstances, entitled to lump-sum severance indemnities and/or pension payments, determined by reference to current basic rate of pay, length of service and conditions under which the termination occurs. The funding policy is to make contributions that can be deducted for Japanese income tax purposes.

The parent company and certain subsidiaries in Japan also have contributory defined benefit pension plans, covering substantially all of their employees, including the governmental welfare pension benefit plan which would otherwise be provided by the Japanese government. The pension benefits are determined based on years of service and the compensation amount as stipulated in the regulations. The governmental welfare pension contributions are funded in conformity with the requirements regulated by the Japanese Welfare Pension Insurance Law. The contributions to the contributory and the non-contributory pension plans are placed into trusteed pension funds.

Most subsidiaries outside Japan have various retirement plans covering substantially all of their employees, which are primarily defined contribution plans. The funding policy for the defined contribution plans is to annually contribute an amount equal to a certain percentage of the participants' annual salaries.

The combined funded status of the defined benefit pension plans at March 31, 1997 and 1998, were as follows:

	In millions of yen		In thousands of U.S. dollars
March 31	1997	**1998**	**1998**
Actuarial present value of benefit obligations:			
Vested benefit obligation	¥522,542	**¥702,836**	**$5,284,481**
Accumulated benefit obligation	¥666,853	**¥861,758**	**$6,479,384**
Projected benefit obligation	¥864,322	**¥951,749**	**$7,156,008**
Plan assets at fair value	(548,975)	**(616,682)**	**(4,636,707)**
Unrecognized prior service cost and net loss	(82,207)	**(109,979)**	**(826,910)**
Unrecognized net obligation at April 1, 1989 being recognized over 17 years	(27,787)	**(24,740)**	**(186,015)**
Additional minimum liability	—	**44,728**	**336,301**
Accrued pension and severance liability stated in the balance sheets	¥205,353	**¥245,076**	**$1,842,677**

The vested benefit obligation shown above is the amount of the actuarial present value of the vested benefits to which the employee is currently entitled but based on the employee's expected date of separation or retirement.

Components of net pension and severance cost for all defined benefit plans including both the company's and employees' contributory portion of such plans for the years ended March 31, 1996, 1997 and 1998 were as follows:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Service cost-benefits earned during the period	¥39,562	¥44,154	**¥44,851**	**$337,226**
Interest cost on projected benefit obligation	32,073	36,487	**38,894**	**292,436**
Actual return on plan assets	(24,154)	(22,296)	**(35,039)**	**(263,451)**
Net amortization and deferral	13,096	13,728	**10,298**	**77,428**
Net pension and severance cost for all defined benefit plans	¥60,577	¥72,073	**¥59,004**	**$443,639**

The weighted-average discount rate and the rate of increase in future compensation levels which were used in determining the actuarial present value of the projected benefit obligation, and the expected long-term rate of return on plan assets were as follows:

Year ended March 31	1996	1997	**1998**
Weighted-average discount rate	4.5%	4.5%	**4.2%**
Rate of increase in future compensation levels	2.1%–3.9%	1.7%–3.8%	**1.7%–3.8%**
Expected long-term rate of return on plan assets	5.0%	5.0%	**4.2%**

The plan assets consist principally of corporate equity securities, government securities and corporate debt securities.

The total cost for all defined benefit and defined contribution plans was as follows:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Net pension and severance cost for all defined benefit plans	¥60,577	¥72,073	**¥59,004**	**$443,639**
Net pension cost for employees' portion of the contributory defined benefit pension plans	(4,887)	(13,144)	**(13,688)**	**(102,917)**
Pension and severance cost for defined contribution plans and severance indemnity plans	459	1,560	**1,952**	**14,676**
Total cost for all defined benefit and defined contribution plans	¥56,149	¥60,489	**¥47,268**	**$355,398**

9 INCOME TAXES

The components of income tax expense are as follows:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Current	¥108,254	¥22,507	**¥67,985**	**$511,165**
Deferred	(31,878)	2,393	**(19,952)**	**(150,015)**
	¥ 76,376	¥24,900	**¥48,033**	**$361,150**

The company is subject to a number of different income taxes which, in the aggregate, indicate a normal statutory tax rate in Japan of approximately 51 percent for the years ended March 31, 1996, 1997 and 1998. On March 31, 1998, the Japanese government passed a law that changed the tax rates for corporations. As a result of the change, a normal statutory tax rate in Japan will be approximately 47 percent for the year beginning on April 1, 1998 and subsequent years. A reconciliation between the reported total income tax expense and the amount computed by multiplying the income before tax by the applicable normal statutory income tax rate is as follows:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Current "expected" tax expense	¥77,172	¥61,823	**¥46,406**	**$348,917**
Increase (decrease) in taxes resulting from:				
a) Disposition of an investment in a consolidated subsidiary	—	(49,980)	**—**	**—**
b) Changes in valuation allowance	(16,068)	8,054	**(12,857)**	**(96,669)**
c) Non-deductible expense for tax purposes	4,126	4,836	**4,570**	**34,361**
d) International tax rate differences	5,096	674	**78**	**586**
e) Effect of change in normal statutory tax rate in Japan	—	—	**6,604**	**49,654**
f) Other	6,050	(507)	**3,232**	**24,301**
Actual total income tax expenses	¥76,376	¥24,900	**¥48,033**	**$361,150**

The significant components of deferred tax assets and liabilities at March 31, 1997 and 1998 are as follows:

March 31	In millions of yen 1997	**1998**	In thousands of U.S. dollars **1998**
Deferred tax assets:			
Intercompany profit on inventories and tangible fixed assets between consolidated companies	¥ 48,720	**¥ 33,909**	**$ 254,955**
Accrued pension and severance costs	49,373	**40,560**	**304,962**
Operating lease	26,256	**33,479**	**251,722**
Loss carryforwards	85,643	**97,504**	**733,113**
Other	88,162	**88,737**	**667,196**
	298,154	**294,189**	**2,211,948**
Less—Valuation allowance	89,008	**65,158**	**489,910**
Total	¥209,146	**¥229,031**	**$1,722,038**
Deferred tax liabilities:			
Tax deductible reserve	¥ 40,563	**¥ 37,423**	**$ 281,376**
Tax on undistributed earnings	12,723	**22,260**	**167,369**
Marketable securities	14,629	**16,710**	**125,639**
Other	28,139	**27,445**	**206,353**
Total	¥ 96,054	**¥103,838**	**$ 780,737**

In Japan, consolidated tax returns are not permitted; accordingly, company subsidiaries are required to file separate tax returns. The valuation allowance is primarily related to deferred tax assets of certain consolidated subsidiaries with operating loss carryforwards which are not expected to be realized. The net changes in the total valuation allowance for the years ended March 31, 1996, 1997 and 1998 were decreases of ¥29,460 million, ¥8,773 million and ¥23,850 million ($179,323 thousand), respectively. Of the changes in the valuation allowance, the amounts attributable to the release of the beginning-of-the-year balance due to favorable developments in the subsequent year for the years ended March 31, 1996, 1997 and 1998 were decreases of ¥14,470 million, ¥15,560 million and ¥21,576 million ($162,226 thousand), respectively.

At March 31, 1998, for tax return purposes, the company had tax loss carryforwards amounting to approximately ¥216,147 million ($1,625,165 thousand) which will expire primarily during the period from 1999 through 2003 and in 2007, 2008 and 2010. Realization is dependent on companies generating sufficient taxable income prior to expiration of the tax loss carryforwards. Although realization is not assured, management believes it is more likely than not that the net deferred tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

10 SHAREHOLDERS' EQUITY

Changes in common stock, additional paid-in capital, legal reserve, cumulative translation adjustments and treasury stock are shown below:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Common stock:				
Balance at beginning of year	¥189,005	¥191,294	**¥200,403**	**$1,506,790**
Conversion of convertible debt	2,289	9,109	**15,650**	**117,669**
Balance at end of year	¥191,294	¥200,403	**¥216,053**	**$1,624,459**
Additional paid-in capital:				
Balance at beginning of year	¥298,095	¥300,374	**¥312,192**	**$2,347,308**
Conversion of convertible debt	2,279	10,207	**18,303**	**137,617**
Change in interest in consolidated subsidiaries	—	1,611	**435**	**3,271**
Gain on sale of treasury stock	—	—	**1**	**7**
Balance at end of year	¥300,374	¥312,192	**¥330,931**	**$2,488,203**
Legal reserve:				
Balance at beginning of year	¥ 27,857	¥ 29,826	**¥ 31,985**	**$ 240,489**
Transfer from retained earnings	1,969	2,159	**2,096**	**15,759**
Balance at end of year	¥ 29,826	¥ 31,985	**¥ 34,081**	**$ 256,248**
Cumulative translation adjustments:				
Balance at beginning of year	¥ (48,910)	¥ (25,536)	**¥ 3,601**	**$ 27,075**
Translation adjustment for the year	23,374	29,137	**9,261**	**69,632**
Balance at end of year	¥ (25,536)	¥ 3,601	**¥ 12,862**	**$ 96,707**
Treasury stock, at cost:				
Balance at beginning of year	¥ (2)	¥ (7)	**¥ (15)**	**$ (113)**
Net change resulting from purchase and sales of fractional shares of less than "One Unit" as defined by the Japanese Commercial Code	(5)	(8)	**7**	**53**
Balance at end of year	¥ (7)	¥ (15)	**¥ (8)**	**$ (60)**

(1) Common stock and additional paid-in capital

Issuances of common stock in connection with conversions of convertible debt for the years ended March 31, 1996, 1997 and 1998 were 4,874,097 shares, 19,454,109 shares and 32,439,230 shares, respectively.

Prior to 1985, the parent company made free share distributions of 233,182,146 shares. The cumulative amount of the fair value of these shares at the time of issuance was ¥258,755 million. Had the company accounted for these free share distributions in the manner used by United States companies, that amount would have been transferred from retained earnings to appropriate capital accounts.

(2) Legal reserve and retained earnings

The Japanese Commercial Code provides that an amount equal to at least 10 percent of cash dividends and other distributions from retained earnings paid by the parent company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriation is required when the legal reserve equals 25 percent of their respective stated capital.

The amount of retained earnings available for dividends is based on the parent company's retained earnings determined in accordance with generally accepted accounting principles and the Commercial Code in Japan. The appropriations of retained earnings for the year ended March 31, 1998, as incorporated in the accompanying consolidated financial statements, include year-end dividends of ¥8,789 million ($66,083 thousand) which, in accordance with the Japanese Commercial Code, was approved at the Ordinary General Meeting of Shareholders which was held on June 26, 1998 and was recorded in the statutory books of account on that date.

11 NET INCOME PER SHARE

Basic and diluted net income per share are computed as follows:

Year ended March 31	In exact shares 1996	1997	**1998**
Number of shares for basic per share computations for net income:			
Weighted-average number of shares of common stock outstanding for the year	1,543,813,308	1,551,017,559	**1,592,406,790**
Add—Incremental shares related to convertible bonds	231,404,097	296,731,689	**254,578,150**
Number of shares for diluted per share computations for net income	1,775,217,405	1,847,749,248	**1,846,984,940**

Year ended March 31	In millions of yen 1996	1997	**1998**	In thousands of U.S. dollars **1998**
Net income available to common shareholders	¥77,166	¥91,581	**¥41,302**	**$310,541**
Net income effect of interest on convertible bonds	2,962	3,354	**3,109**	**23,376**
Net income available to common shareholders and assumed conversions	¥80,128	¥94,935	**¥44,411**	**$333,917**

Year ended March 31	Yen 1996	1997	**1998**	U.S. dollars **1998**
Net income per share of common stock:				
Basic	¥49.98	¥59.05	**¥25.94**	**$0.195**
Diluted	45.14	51.38	**24.05**	**0.181**

12 FINANCIAL INSTRUMENTS

(1) Fair value of financial instruments

The carrying amounts of cash and cash equivalents, time deposits, notes and accounts receivable and payable, trade, short-term borrowings, employees' savings deposits, accrued taxes on income and other current assets and liabilities approximated fair value because of their short-term maturities. The carrying amounts and estimated fair values of the other financial instruments are summarized as follows:

March 31	In millions of yen 1997 Carrying amount	1997 Estimated fair value	**1998** Carrying amount	**1998** Estimated fair value	In thousands of U.S. dollars **1998** Carrying amount	**1998** Estimated fair value
Marketable and investment securities	¥ 339,335	¥ 538,134	**¥ 349,866**	**¥ 504,864**	**$2,630,572**	**$ 3,795,970**
Long-term receivables, trade	43,162	44,107	**40,111**	**41,010**	**301,586**	**308,346**
Long-term loans	30,443	30,464	**21,533**	**21,677**	**161,902**	**162,985**
Long-term debt, including current portion and excluding capital lease obligation	(1,247,177)	(1,307,914)	**(1,324,527)**	**(1,377,861)**	**(9,958,850)**	**(10,359,857)**
Derivatives:						
Forward exchange contracts	(730)	(743)	**279**	**209**	**2,098**	**1,571**
Interest rate and currency swap agreements	(2,557)	2,048	**5,194**	**(2,621)**	**39,053**	**(19,707)**
Option contracts— Purchased	567	296	**440**	**338**	**3,308**	**2,541**
Written	(7)	(7)	**0**	**0**	**0**	**0**

The fair values of financial instruments at March 31, 1997 and 1998 are determined by using a variety of methods and assumptions such as reference to various market and other data as appropriate. For marketable securities, fair value is determined based on quoted market prices. For investment debt securities, fair value is determined based on information obtained from independent third parties. For long-term receivables, trade and long-term loans included in investments and advances—other, fair value is estimated using estimated discounted values of future cash flows. For long-term debt, fair value is estimated using market quotes, or where market quotes are not available, using estimated discounted future cash flows for the same or similar types of instruments. Investments in equity securities, included in investments and advances—other, with an aggregated carrying value of ¥77,383 million and ¥91,454 million ($687,624 thousand) at March 31, 1997 and 1998, respectively, consist of numerous investments in securities of non-public companies. It is not practicable to reasonably estimate the fair values of these investments. Fair value of the forward exchange contracts is estimated by obtaining quotes for futures contracts with similar maturities, and fair value of the interest rate and currency swap agreements is estimated based on the discounted values of net future cash flows, and fair value of the option contracts is estimated using pricing models based upon current market interest and foreign exchange rates and volatilities.

(2) Derivative financial instruments

In the normal course of business, the company enters into various derivative financial instruments in order to manage exposures resulting from fluctuations in foreign currency exchange rates and interest rates. The primary classes of derivatives used by the company are forward exchange contracts, interest rate swap agreements, currency swap agreements and foreign currency purchased and written options as a normal part of its risk management efforts, which include those transactions designed as hedges but that do not qualify for hedge accounting under accounting principles generally accepted in the United States of America. Gains and losses on those derivative financial instruments qualified for hedge accounting are deferred and effectively offset gains and losses on the underlying hedged assets and liabilities by recognizing them in the same period. Other derivatives used for hedging purposes but not qualifying for hedge accounting under accounting principles generally accepted in the United States of America are marked to market.

The forward exchange contracts have been entered into as hedges against the adverse impact of fluctuations in foreign currency exchange rates on monetary assets and liabilities denominated in foreign currencies arising from the company's operating activities. The company had outstanding forward exchange contracts which, at March 31, 1997, mature through September 1997 to purchase the equivalent of ¥120,475 million, principally U.S. Dollars, and to sell the equivalent of ¥110,671 million, principally U.S. Dollars and German Marks, of various foreign currencies. At March 31, 1998, the company had outstanding forward exchange contracts which mature through March 1999 to purchase the equivalent of ¥85,082 million ($639,714 thousand), principally U.S. Dollars, and to sell the equivalent of ¥49,345 million ($371,015 thousand), principally U.K. Pounds, German Marks and U.S. Dollars, of various foreign currencies.

The interest rate swap agreements are fully integrated with underlying debt obligations and designed to convert fixed rate debt into floating rate debt, or vice versa, and interest rate option agreements are also arranged so that exposures to losses resulting from fluctuations in interest rates are managed. The currency swap agreements and options are designed to limit exposures to losses resulting from fluctuations in foreign currency exchange rates. The aggregate notional principal amounts for interest rate swap agreements and currency swap agreements were ¥305,286 million and ¥527,188 million ($3,963,820 thousand) at March 31, 1997 and 1998, respectively. These agreements mature through 2009. The differentials to be paid or received related to interest rate swap agreements are recognized in interest expense over the terms of the agreements. The notional principal amounts of purchased interest rate option contracts were ¥29,587 million and ¥29,737 million ($223,586 thousand) at March 31, 1997 and 1998, respectively. These agreements mature through 2007. The notional principal amounts of written interest rate option contracts at March 31, 1997 and 1998 were ¥2,482 million and ¥2,642 million ($19,865 thousand). These agreements mature through 1998.

The counterparties to the company's derivative transactions are major financial institutions. As a normal business risk, the company is exposed to credit loss in the event of nonperformance by the counterparties, however, the company does not anticipate nonperformance by the counterparties to these agreements, and no material losses are expected.

13 RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses included in selling, general and administrative expenses approximated ¥298,713 million, ¥348,537 million and ¥381,239 million ($2,866,459 thousand) for the years ended March 31, 1996, 1997 and 1998, respectively.

14 ADVERTISING COSTS

The company expenses advertising costs as incurred. Advertising expenses amounted to ¥40,162 million, ¥42,527 million and ¥45,684 million ($343,489 thousand) for the years ended March 31, 1996, 1997 and 1998, respectively.

15 EXCHANGE GAINS AND LOSSES

Foreign currency transaction gains and losses which were included in other income were as follows:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Net exchange gains	¥511	¥19,373	**¥1,954**	**$14,692**

16 LEASING ARRANGEMENTS

(1) Leasing of computer equipment

In the normal course of business, the company sells certain equipment to an affiliated financing company which in turn leases the equipment to certain government and government agency customers under operating leases. The company also agrees to repurchase that equipment at prescribed amounts at the expiration of the lease. The company has previously accounted for these transactions as sales which is consistent with accounting practices in Japan. The estimated accrued losses arising from future repurchases of computers have been provided for. Effective December 1, 1995, the company began to account for these transactions as assets owned and leased to others under operating leases as required by accounting principles generally accepted in the United States of America. The company has not restated prior periods because the effect on earnings of applying the new accounting practice is not material. During a period of transition, which will continue for approximately three years, income before taxes was reduced by ¥19,528 million for the year ended March 31, 1996, ¥23,800 million for the year ended March 31, 1997 and ¥17,309 million ($130,143 thousand) for the year ended March 31, 1998 compared to income that would have been reported if the company had previously followed the new accounting practice.

At March 31, 1997 and 1998, the company invested in computer equipment to be leased to others as described above, amounting to ¥80,733 million less accumulated depreciation of ¥44,218 million and ¥70,640 million ($531,128 thousand) less accumulated depreciation of ¥39,131 million ($294,218 thousand), respectively. Future minimum lease payments from noncancelable leases as of March 31, 1998 are ¥7,798 million ($58,632 thousand) and ¥605 million ($4,549 thousand) for the years ending March 31, 1999 and 2000, respectively.

(2) Lease of facilities and equipment for the company's use

The company leases certain facilities and equipment for its own use. Gross amount of leased assets under capital leases included in machinery and equipment was ¥77,747 million and ¥107,287 million at March 31, 1997 and 1998, respectively. Accumulated amortization of the leased assets at March 31, 1997 and 1998 was ¥28,147 million and ¥46,708 million, respectively.

The following is a schedule by year of the future minimum lease payments under capital leases together with the present value of the net minimum lease payments at March 31, 1998:

Year ending March 31	In millions of yen	In thousands of U.S. dollars
1999	¥21,646	$162,752
2000	19,540	146,917
2001	15,478	116,376
2002	11,890	89,398
2003	4,935	37,105
2004	639	4,805
Total minimum lease payments	74,128	557,353
Less—Amount representing interest	6,348	47,729
Present value of net minimum lease payments	67,780	509,624
Less—Current obligation	19,620	147,519
Long-term lease obligation	¥48,160	$362,105

Rental expenses under operating leases were as follows:

	In millions of yen			In thousands of U.S. dollars
Year ended March 31	1996	1997	**1998**	**1998**
Rental expenses under operating leases	¥111,049	¥120,056	**¥122,730**	**$922,782**

Future minimum rental payments are as follows:

Year ending March 31	In millions of yen	In thousands of U.S. dollars
1999	¥16,028	$120,511
2000	14,732	110,767
2001	8,582	64,526
2002	4,895	36,805
2003	4,043	30,398
2004 and thereafter	18,291	137,526

17 COMMITMENTS AND CONTINGENT LIABILITIES

Commitments outstanding at March 31, 1998 for the purchase of property, plant and equipment approximated ¥40,498 million ($304,496 thousand).

Contingent liabilities at March 31, 1998 for notes discounted, loans guaranteed and other guarantees amounted to approximately ¥256,114 million ($1,925,669 thousand).

18 SUBSEQUENT EVENTS

(1) On April 23, 1998, the parent company issued ¥50,000 million ($375,940 thousand) of 2.6 percent unsecured yen debentures due 2008 by public offerings. The issue price was 100 percent of the face value of the bonds.

(2) On May 25, 1998, the parent company issued ¥30,000 million ($225,564 thousand) of 1.2 percent unsecured yen debentures due 2001 and ¥30,000 million ($225,564 thousand) of 1.9 percent unsecured yen bonds due 2005 by public offerings. The issue price was 100 percent of the face value of the bonds.

(3) Based on the resolution of the Board of Directors meeting of the parent company, which was held on June 26, 1998, the parent company announced on July 7, 1998 to issue ¥20,000 million ($150,376 thousand) of 1.55 percent unsecured yen debentures due 2003, ¥20,000 million ($150,376 thousand) of 1.9 percent unsecured yen debentures due 2005 and ¥30,000 million ($225,564 thousand) of 2.25 percent unsecured yen debentures due 2008 by public offerings on July 22, 1998. The issue price will be 100 percent of the face value of the bonds.

Report of Independent Accountants

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Price Waterhouse

July 17, 1998

To the Board of Directors and Shareholders of NEC Corporation
(Nippon Denki Kabushiki Kaisha)

We have audited the accompanying consolidated balance sheets of NEC Corporation and its consolidated subsidiaries as of March 31, 1997 and 1998, and the related consolidated statements of income and retained earnings and of cash flows for each of the three years in the period ended March 31, 1998, stated in yen. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The company has not applied Statement of Financial Accounting Standards ("SFAS") No. 115 in accounting for certain investments in debt and equity securities but has provided the disclosures as required by the provisions of SFAS No. 115. The effects on the consolidated financial statements of not adopting SFAS No. 115 are summarized in Note 5 to the consolidated financial statements.

The company has not presented segment information for each of the three years in the period ended March 31, 1998. The presentation of segment information concerning operations in different industries, foreign operations and export sales, and major customers is required by accounting principles generally accepted in the United States of America for a complete presentation of consolidated financial statements.

In our opinion, except for the effects of the departure from SFAS No. 115 in accounting for certain investments in debt and equity securities as discussed in the third paragraph, and the omission of segment information as discussed in the fourth paragraph of this report, the consolidated financial statements audited by us present fairly, in all material respects, the financial position of NEC Corporation and its consolidated subsidiaries at March 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 1998, in conformity with accounting principles generally accepted in the United States of America.

Price Waterhouse

Consolidated Statements of Income and Retained Earnings

NEC CORPORATION AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 1996, 1997 and 1998

	In millions of yen			In thousands of U.S. dollars (Note 3)
	1996	1997	**1998**	**1998**
Sales and other income:				
Net sales	¥4,397,192	¥4,948,437	**¥4,901,122**	**$36,850,541**
Interest, gain on securities sold, dividends and other (Notes 5 and 15)	30,080	116,435	**69,564**	**523,038**
	4,427,272	5,064,872	**4,970,686**	**37,373,579**
Costs and expenses:				
Cost of sales	2,980,718	3,528,326	**3,409,607**	**25,636,143**
Selling, general and administrative (Notes 13 and 14)	1,168,672	1,236,330	**1,301,111**	**9,782,789**
Interest	69,793	60,463	**61,257**	**460,579**
Other	56,771	118,531	**107,718**	**809,910**
	4,275,954	4,943,650	**4,879,693**	**36,689,421**
Income before income taxes	151,318	121,222	**90,993**	**684,158**
Income taxes (Note 9)	76,376	24,900	**48,033**	**361,150**
Income before minority interest and equity in earnings of affiliated companies	74,942	96,322	**42,960**	**323,008**
Minority interest in consolidated subsidiary companies	4,029	5,018	**2,839**	**21,346**
Income before equity in earnings of affiliated companies	70,913	91,304	**40,121**	**301,662**
Equity in earnings of affiliated companies (Note 4)	6,253	277	**1,181**	**8,879**
Net income	77,166	91,581	**41,302**	**310,541**
Retained earnings:				
Balance at beginning of year	324,704	382,901	**455,205**	**3,422,594**
Cash dividends applicable to earnings for the year	(17,000)	(17,118)	**(17,573)**	**(132,128)**
Transfer to legal reserve	(1,969)	(2,159)	**(2,096)**	**(15,759)**
Balance at end of year	¥ 382,901	¥ 455,205	**¥ 476,838**	**$ 3,585,248**

	Yen			U.S. dollars (Note 3)
	1996	1997	**1998**	**1998**
Net income per share of common stock (Note 11):				
Basic	¥49.98	¥59.05	**¥25.94**	**$0.195**
Diluted	45.14	51.38	**24.05**	**0.181**
Cash dividends per share	¥11.00	¥11.00	**¥11.00**	**$0.083**

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

NEC CORPORATION AND CONSOLIDATED SUBSIDIARIES
For the years ended March 31, 1996, 1997 and 1998

	In millions of yen			In thousands of U.S. dollars (Note 3)
	1996	1997	**1998**	**1998**
Cash flows from operating activities:				
Net income	¥ 77,166	¥ 91,581	**¥ 41,302**	**$ 310,541**
Adjustments to reconcile net income to net cash provided by operating activities—				
Depreciation	260,247	272,933	**285,862**	**2,149,338**
Deferred income taxes	(31,878)	(2,193)	**(11,073)**	**(83,256)**
Accrual for pension and severance costs, less payments	16,407	10,614	**(5,197)**	**(39,075)**
Equity in earnings of affiliated companies, net of dividends	(1,760)	12,514	**8,596**	**64,632**
Minority interest in consolidated subsidiary companies	4,029	5,018	**2,839**	**21,346**
(Increase) decrease in notes and accounts receivable	(174,871)	46,925	**(30,913)**	**(232,429)**
(Increase) decrease in inventories	(146,225)	126,946	**77,655**	**583,872**
Increase (decrease) in notes and accounts payable	296,144	(179,355)	**(54,706)**	**(411,323)**
Increase (decrease) in accrued taxes on income	15,774	(48,009)	**(3,885)**	**(29,210)**
Increase (decrease) in employees' savings deposits	5,333	(92,302)	**(3,914)**	**(29,428)**
Other, net	(36,568)	12,277	**(10,431)**	**(78,429)**
Net cash provided by operating activities	283,798	256,949	**296,135**	**2,226,579**
Cash flows from investing activities:				
Proceeds from sales of property, plant and equipment	12,394	40,072	**5,794**	**43,564**
Additions to property, plant and equipment	(341,907)	(452,109)	**(393,776)**	**(2,960,722)**
Proceeds from sales of marketable securities	11,506	118,259	**22,419**	**168,564**
Payments for purchase of marketable securities	(22,117)	(104,419)	**(46,606)**	**(350,421)**
Investments in affiliated companies	(22,367)	(71,064)	**(71,803)**	**(539,872)**
Disbursements for long-term loans	(16,067)	(5,694)	**(2,703)**	**(20,323)**
Decrease in long-term loans	19,349	10,236	**11,642**	**87,533**
Other, net	3,255	(2,981)	**(38,547)**	**(289,827)**
Net cash used in investing activities	(355,954)	(467,700)	**(513,580)**	**(3,861,504)**
Cash flows from financing activities:				
Proceeds from long-term debt	146,433	252,152	**360,892**	**2,713,474**
Repayment of long-term debt	(156,516)	(150,220)	**(167,762)**	**(1,261,368)**
Increase in short-term borrowings	26,644	91,252	**10,032**	**75,429**
Dividends paid	(15,426)	(17,782)	**(17,407)**	**(130,880)**
Other, net	(259)	(540)	**749**	**5,631**
Net cash provided by financing activities	876	174,862	**186,504**	**1,402,286**
Effect of exchange rate changes on cash and cash equivalents	6,238	5,378	**(577)**	**(4,338)**
Net decrease in cash and cash equivalents	(65,042)	(30,511)	**(31,518)**	**(236,977)**
Cash and cash equivalents at beginning of year	446,047	381,005	**350,494**	**2,635,293**
Cash and cash equivalents at end of year	¥381,005	¥350,494	**¥318,976**	**$2,398,316**
Supplemental disclosures of cash flow information:				
Cash paid during the year for—				
Interest	¥ 71,138	¥ 62,941	**¥ 61,412**	**$ 461,744**
Income taxes	¥ 87,780	¥ 71,399	**¥ 88,844**	**$ 668,000**
Supplemental information of noncash financing activities:				
Conversion of convertible debt into common stock and additional paid-in capital	¥ 4,568	¥ 19,326	**¥ 33,957**	**$ 255,316**

The accompanying notes are an integral part of these statements.

Report of Independent Accountants

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Price Waterhouse

July 17, 1998

To the Board of Directors and Shareholders of NEC Corporation
(Nippon Denki Kabushiki Kaisha)

We have audited the accompanying consolidated balance sheets of NEC Corporation and its consolidated subsidiaries as of March 31, 1997 and 1998, and the related consolidated statements of income and retained earnings and of cash flows for each of the three years in the period ended March 31, 1998, stated in yen. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The company has not applied Statement of Financial Accounting Standards ("SFAS") No. 115 in accounting for certain investments in debt and equity securities but has provided the disclosures as required by the provisions of SFAS No. 115. The effects on the consolidated financial statements of not adopting SFAS No. 115 are summarized in Note 5 to the consolidated financial statements.

The company has not presented segment information for each of the three years in the period ended March 31, 1998. The presentation of segment information concerning operations in different industries, foreign operations and export sales, and major customers is required by accounting principles generally accepted in the United States of America for a complete presentation of consolidated financial statements.

In our opinion, except for the effects of the departure from SFAS No. 115 in accounting for certain investments in debt and equity securities as discussed in the third paragraph, and the omission of segment information as discussed in the fourth paragraph of this report, the consolidated financial statements audited by us present fairly, in all material respects, the financial position of NEC Corporation and its consolidated subsidiaries at March 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 1998, in conformity with accounting principles generally accepted in the United States of America.

Price Waterhouse

Directors and Corporate Auditors

(As of June 26, 1998)

Changes in Management

Effective June 26, 1998, Tatsuo Sakairi, formerly Executive Vice President, was named Senior Executive Vice President. Yoshi Takayama, Masato Chiba, and Mineo Sugiyama, formerly Senior Vice Presidents, were named Executive Vice Presidents. Yukihiko Baba, Kanji Sugihara, Iwao Shinohara, and Kaoru Tosaka, formerly Associate Senior Vice Presidents, were named Senior Vice Presidents.

At the Ordinary General Meeting of Shareholders held on June 26, 1998, Shigeki Matsue, formerly the President and CEO of NEC Electronics Inc., Yukio Doi, formerly Advisor, Yasushi Kaito, formerly Vice President, Masakatsu Miwa, formerly General Manager, General Affairs Division, and Kazumasa Fujie, formerly General Manager, Government and Public Sector Planning Division, were newly elected to the Board of Directors. Toshio Ono, appointed as a director in 1990 and later serving as Executive Vice President, retired from the Board of Directors and was newly elected Corporate Auditor, effective the same date.

Yoshihiro Suzuki, formerly Senior Executive Vice President and a director since 1989, Tomoo Miyawaki, formerly Executive Vice President and a director since 1990, Kenjiro Nitta and Hiroaki Shimayama, formerly Executive Vice Presidents and directors since 1991, and Kaneo Suzuki, formerly Associate Senior Vice President and a director since 1993, retired from the Board of Directors, and Jiro Okuda, appointed as Corporate Auditor in 1991, retired on June 26, 1998.

Directors

Tadahiro Sekimoto
Chairman of the Board

Hisashi Kaneko
President

Seijiro Yokoyama
Senior Executive Vice President

Hajime Sasaki
Senior Executive Vice President

Tatsuo Sakairi
Senior Executive Vice President

Kouji Nishigaki
Executive Vice President

Masami Shinozaki
Executive Vice President

Hirokazu Akiyama
Executive Vice President

Yoshi Takayama
Executive Vice President

Masato Chiba
Executive Vice President

Mineo Sugiyama
Executive Vice President

Eiichi Yoshikawa
Senior Vice President

Shigeo Matsumoto
Senior Vice President

Hiroshi Shiba
Senior Vice President

Yoshio Omori
Senior Vice President

Kazuhiko Kanou
Senior Vice President

Yukihiko Baba
Senior Vice President

Kanji Sugihara
Senior Vice President

Iwao Shinohara
Senior Vice President

Kaoru Tosaka
Senior Vice President

Kyonosuke Ibe
Advisor, The Sumitomo Bank, Limited

Takashi Torii
Associate Senior Vice President

Tatsuo Ishiguro
Associate Senior Vice President

Norio Saito
Associate Senior Vice President

Shigeki Matsue
Associate Senior Vice President

Akinobu Kanasugi
Associate Senior Vice President

Kaoru Yano
Associate Senior Vice President

Hiromi Hayashi
Associate Senior Vice President

Kouichi Ohtsuka
Associate Senior Vice President

Toshiki Inazumi
Associate Senior Vice President

Toshiro Kawamura
Associate Senior Vice President

Keiichi Shimakura
Associate Senior Vice President

Kazuhiko Kobayashi
Associate Senior Vice President

Yukio Doi
Associate Senior Vice President

Yasushi Kaito
Associate Senior Vice President

Masakatsu Miwa
Associate Senior Vice President

Kazumasa Fujie
Associate Senior Vice President

Corporate Auditors

Tadashi Suzuki

Toshio Ono

Satoshi Tamaki

Masaaki Arai
Honorary Chairman,
Sumitomo Life Insurance Company

Michio Nishi
Attorney at Law, Nishi & Partners

Corporate Directory

(As of March 31, 1998)

Facilities

JAPAN

Consolidated Subsidiaries

The Company has 89 consolidated subsidiaries throughout Japan.

Manufacturing Plants

The Company has eight major plants in or near Tokyo, and its consolidated subsidiaries maintain 53 plants throughout Japan.

Marketing Network

The Company and its consolidated subsidiaries have more than 420 sales offices located in major cities throughout Japan.

R&D Facilities

The Company has five R&D facilities near Tokyo and two in the Osaka area.

OVERSEAS

Consolidated Subsidiaries

The Company has 42 consolidated subsidiaries in 16 countries.

Manufacturing Plants

The Company's 57 majority-owned manufacturing subsidiaries and affiliates (in which it has ownership interests of 20% to 50%) operate a total of 57 plants in 19 countries.

Marketing Network

The Company has 114* marketing and service subsidiaries and affiliates in 30 countries and 22 liaison offices in 22 countries.

R&D Facilities

The Company has three R&D facilities in the United States and three in Germany.

*Including 42 manufacturing subsidiaries and affiliates

Major Consolidated Subsidiaries

JAPAN

NEC Home Electronics, Ltd.
NEC Kansai, Ltd.
NEC Personal Systems, Ltd.
NEC Kyushu, Ltd.
NEC Field Service, Ltd.
NEC Kofu, Ltd.
NEC Yonezawa, Ltd.
NEC Tohoku, Ltd.
NEC Shizuoka, Ltd.
NEC Ibaraki, Ltd.
NEC Logistics, Ltd.
NEC Gunma, Ltd.
NEC Nagano, Ltd.
NEC Saitama, Ltd.
Japan Aviation Electronics Industry, Limited
Ando Electric Company, Limited
NEC System Integration & Construction, Ltd.
Nippon Avionics Co., Ltd.

OVERSEAS

NEC Electronics Inc. (U.S.A.)
NEC America, Inc. (U.S.A.)
NEC Technologies, Inc. (U.S.A.)

Shareholder Information

Transfer Agent for Common Stock

The Sumitomo Trust and Banking Company, Limited
4-4, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8233, Japan

Stock Exchange Listings and Quotations

NEC common stock is listed on the Tokyo and seven other stock exchanges in Japan. Overseas listings are on the Swiss Exchange (in the form of Swiss Bearer Depositary Receipts), the Frankfurt Stock Exchange (in the form of a Global Bearer Certificate), the London Stock Exchange, and Amsterdam Exchanges. American Depositary Receipts for common stock (Symbol: NIPNY) are quoted in the NASDAQ system in the United States.

Depositary for American Depositary Receipts (ADRs)

The Bank of New York
101 Barclay Street, New York, NY 10286, U.S.A.
Tel: (212) 815-2204
U.S. toll free: (888) 269-2377 (888-BNY-ADRS)

Sponsoring Bank for Global Bearer Certificate (GBC)

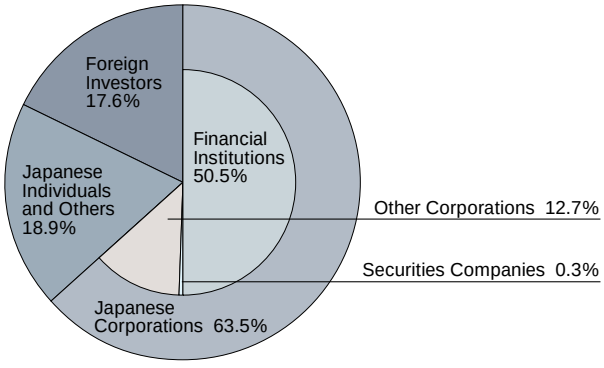
Deutsche Bank A.G.
Taunusanlage 12, 60262 Frankfurt am Main, Germany

Depositary Agent for Swiss Bearer Depositary Receipts (SBDRs)

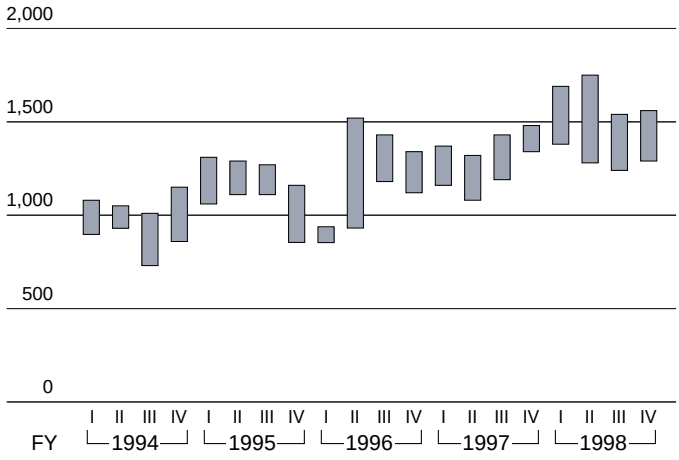
UBS AG
Aeschenvorstadt 1, 4002 Basel, Switzerland

Composition of Shareholders

(As of March 31, 1998)



Stock Price Range on the Tokyo Stock Exchange (Yen)



ADR (NASDAQ) Price Range (U.S. dollars)